south east water

South East Water Limited

Group Financial Statements

31 March 2014

Registered Number: 02679874

Contents

Directors and Secretary

Directors

G W Maxwell (Chairman)

P Butler (Managing Director)

J E Stimpson (Finance Director)

P Seeley (Operations Director)

S George (Customer Services Director)

D Hinton (Asset and Regulation Director) (appointed 1 June 2013)

V Rosati (Non-executive director)

J-P Ouellet (Non-executive director) (appointed 25 July 2013)

P Dixon (Non-executive director) (appointed 27 February 2014)

P Côté (Non-executive director) (appointed 27 February 2014)

D G Shore (resigned 30 June 2013)

J-E Leroux (Non-executive director) (resigned 26 February 2014)

K Bhatia (Non-executive director) (resigned 15 January 2014)

Independent non-executive directors

G H Setterfield

E Gilthorpe

P Rich (appointed 25 April 2013)

R Weeden (Resigned 25 April 2013)

Company Secretary

N Truillet

Registered Office

Rocfort Road
Snodland
Kent
ME6 5AH

Registered No. 02679874

Country of domicile and incorporation: the United Kingdom

Chairman's Introduction

Throughout this extremely busy year, the South East Water Board has been committed to ensuring that customer priorities are at the heart of everything we do. I have ensured that the Board has engaged with Ofwat and the evolving regulatory requirements as we submit our Business Plan and prepare for the next regulatory period, when we will see the introduction of competition for non-domestic customers.

The Board has steered the direction of our Business Plan for 2015 to 2020, as well as our 25-year Water Resources Management Plan which has now been published. We recognise that it is our collective responsibility to provide strategic leadership, and to promote good corporate governance through the development of these plans.

We have worked together to ensure that these plans continue to assure the long-term success of the company, striking the right balance between the interests of current and future customers, the communities we serve, the environment, our colleagues at South East Water and our shareholders.

Our financial and operational performance continues to be strong. Group operating profit of £96.2m reflects a similar underlying profit performance as 2012/13 although the prior year additionally benefited from an exceptional pension curtailment gain as a result of the planned closure of the pension scheme. Profit before tax has increased from £41.6 million to £51.4 million, principally due to the effect of future interest rate expectations on the fair value of our interest rate swap, significantly reducing the cost of this derivative during the year. Operationally, we have met our leakage targets and provided high quality drinking water to 2.1 million people across South East England.

In addition, we have now installed more than 152,000 water meters across our region in the current Price Review period, allowing us to work with our customers to promote using water wisely and reducing demand across our water-stressed region.

We invested £99.6 million in the South East this year to improve services for our customers and to help safeguard the environment and we are committed to continue this level of investment and to deliver this in a way that will ensure the best outcomes for our customers, the environment and those who invest in our industry. I would like to thank my Board and all South East Water employees for their ongoing commitment and support.

Gordon Maxwell
Chairman
4 July 2014

Strategic report

Managing Director's introduction

On behalf of the Directors of South East Water, I am pleased to present our Strategic Report for the company as part of our Annual Report and Financial Statements for the year ended 31 March 2014.

This report looks at our business activities, particularly over the last year and also considers our future plans and the risks and uncertainties we need to prepare for.

It is vital that we plan ahead over many years to ensure we can deliver a reliable supply of quality drinking water to our customers at a fair price, both now and into the future. This has been a significant focus this year as we have worked to prepare both our Business Plan and Water Resources Management Plan.

I have summarised the main points in respect of our performance, Business Plan and Water Resources Management Plan below.

Our Performance

Our activities during the year have continued to be driven by our ongoing commitment to improve our service to customers. We recognise this is an area we need to improve and keep focussed on to ensure that our customers receive an excellent service.

I am pleased to report that there has been further improvement in our performance. Our customer complaints have fallen again this year by over 29%. However, we know there is more we can do and everyone in South East Water is committed to continuously improving their performance.

There have been a number of key initiatives in the year to improve communication with our customers. We have redesigned our customer bills and developed the opportunities for contact via social media. This has been particularly useful in keeping customers up-to-date during supply interruptions.

We are pleased to report that security of supply has been maintained for customers and our water resources remain in a healthy state following the extremely wet winter of 2013/14.

Our on-going investment in leak detection and repair has enabled us to beat our leakage target for the 12th year in a row and we continue to use new technology to drive the leakage levels down further.

Our financial performance remains satisfactory. Our profit before tax was £51.4 million, which includes a significant reduction in the cost of our interest rate swap during the year due to market expectations of future interest rates. Further details of our financial performance are set out on page 11.

Our capital investment programme continues to be on track and deliver the investment required to provide our customers with a high quality service. We have delivered £99.6 million of investment during the year. This included five new ultraviolet treatment plants to ensure we continue to meet drinking water quality standards; £31.9 million investment in improvements at key water treatment works in Kent, Sussex and Berkshire; continuation of our customer metering programme with the installation of over 52,000 meters; and maintenance of our extensive and complex infrastructure network to ensure water supplies are maintained.

It is also important that we continue to motivate and develop our employees. We have invested in a new Learning and Development programme and our apprenticeship scheme is yielding results. Developing the next generation for our industry is vital for our sustainability as a business.

Our Business Plan for 2015 to 2020

We have engaged with household and business customers, key stakeholders and the South East Water Customer Challenge Group about the content of our plan, about the changes we may need to make and the impact on customers' future water supply service and the level of water bills.

Strategic report

Managing Director's introduction

We have consulted extensively with our customers and stakeholders and this has been vital to our planning. The feedback we have received has played a crucial role in the development of our Business Plan for 2015 to 2020 and our goal is to continue to deliver customers' top priorities: clean water, low leakage, effective service, affordable bills and reliable supplies. In addition, we have set ourselves a significant challenge to be more efficient in the way we run our business.

Our Plan is to invest £475 million (gross capital expenditure) over the next five years, which represents an increase of 6% compared to the current level of investment in this Price Review period.

Our Business Plan was submitted in December 2013 and further evidence was presented at the end of June 2014. We now await the results of the review by Ofwat who will issue a final determination in December.

Water Resources Management Plan for 2015 to 2040

We have reached an important stage in helping to secure future water supplies for today's and tomorrow's customers.

In May 2013 we published our draft Water Resources Management Plan, which sets out what we will need to do, where and by when to meet the future need for water from people, businesses and also the environment. We asked for customers' views on these proposals during a 12 week public consultation.

Customers overwhelmingly supported our proposals to reduce demand for water, through our water efficiency, on-going customer metering and leakage reduction programmes, and also supported further investigation into options to increase our reservoir capacity and water re-use.

I would like to thank everyone who took part in the consultation including our Environment Focus Group with membership from local interest groups, regulators and other stakeholders. We are pleased that the Secretary of State approved our plan in May 2014. The plan has now been published and we have begun work on its implementation.

Finally, I would like to thank all my colleagues for their efforts during the year. In particular, the dedication shown during the storms and floods at Christmas and into 2014 was excellent and demonstrated a clear passion across the whole company for ensuring we are providing an excellent service to customers whatever the weather.

I hope that you will find this report both interesting and informative. Further information is available in our Annual Performance Report and our Environmental and Social Achievements Report.

Paul Butler
Managing Director
4 July 2014

Strategic report

Our business

South East Water is responsible for supplying clean safe drinking water to over 2.1 million people across 5,657 square kilometres of Kent, Sussex, Hampshire, Surrey and Berkshire.

We supply our customers by taking water from rivers, reservoirs and underground sources called aquifers and treating it to the highest standards before distributing it through 14,400 kilometres of water mains, which is enough pipe to go 74 times around the M25.

We are committed to supplying high quality drinking water round the clock, helping to conserve water resources, finding and preventing leaks, protecting the environment and guaranteeing standards of service for customers.

South East Water provides a drinking water supply service. We do not provide wastewater services. For our customers, mains drainage and wastewater treatment services are provided by either Thames Water or Southern Water.

We operate within a strict regulatory environment and work closely with our regulators to ensure that we are delivering a great service for our customers both now and in the future. The Water Services Regulation Authority (Ofwat) regulates our prices and levels of customer service. The Drinking Water Inspectorate monitors drinking water quality and the Environment Agency covers environmental protection. Customers' interests are represented by the Consumer Council for Water (CCWater). Our Code of Practice "Your Water Company" provides more details on who our regulators are and what they do.

South East Water Limited is owned by HDF (UK) Holdings Limited which is itself owned by two pension funds in Australia and Canada. These are: Utilities of Australia Pty Limited and Caisse de dépôt et placement du Québec. South East Water Limited has a subsidiary called South East Water (Finance) Limited which it uses to raise money in the financial markets. We have many other stakeholders that care about our business, including our employees, our communities and our customers. Our Environment and Social Achievements Report details how we are working to meet these different stakeholder group requirements.

Strategy and Objectives

This is the final year of our current five year investment programme and preparations during the year for our 2015-2020 Business Plan have given us an opportunity to review our strategy.

Our plan is bold, ambitious and innovative, not just in what we will deliver over the next five years, but in how we will measure our performance and be publicly held accountable for it.

We will make sure the service we provide – and customers expect – is underpinned by rigorous monitoring of our performance and supported by incentives centred on achieving customer satisfaction.

Our clear purpose and ambitions have helped define our vision to strive at all times to exceed our customers' and our stakeholders' expectations in every aspect of water supply.

The table overleaf summarises the Key Performance Indicators ("KPIs") we currently use to measure our progress towards achieving our goals and priorities through non-financial measures. We have also published our Annual Performance Report 2013-14 which provides more detail on each of the KPIs, the challenges we face and our future plans to ensure we continue to improve and develop a focus on customer and stakeholder outcomes for the next five years.

Strategic report

Key Goals	Our Priorities	KPI	Performance 2012-13	Performance 2013-14	Unit
Delivering an Excellent level of service	**Water Quality**	DWI compliance standard Water Quality	99.96	99.97	%
Delivering an Excellent level of service and improving the environment	**Water Supply**	Security of Supply (SOSi)	100	100	Index Score
		Greenhouse gas emissions	82.7	74.8	ktCO2e
		Environmental pollution incidents	0.70	0.69	Category 1-3 incidents per 10,000km of main
Delivering an excellent level of service	**Water Demand**	Percentage of customers on a water meter	54.00%	62.40%	%
		Economic Level of Leakage	93.16	92.56	Megalitres per day
		Assumed savings through water efficiency promotions	1.21	1.21	Megalitres per day
Delivering an Excellent level of service and creating value for our community	**Our Assets**	Interruptions to customers water supplies	0.22	0.27	Hours per total property served
		Serviceability assessment of the water network	Stable	Stable	Assessment
Delivering an Excellent level of service	**Customer service**	SIM	72.66	75.38	Score

How we do what we do

Managing water resources

We provide our customers with water for domestic and commercial purposes. This includes essential water uses such as drinking, washing, cooking, central heating and sanitation, as well as non-essential uses, such as watering the garden and washing the car. We provide water to non-domestic entities such as hospitals and schools, for agriculture and businesses.

We are required to plan for the long-term and we do this by preparing a Water Resources Management Plan which considers likely demand and the options to meet it over the next 25 years. During this timescale our forecasts indicate that the household population will increase by 19%.

Despite the challenges from a growing population our demand management activities will help save an extra one million litres of water every day on top of the 5.2 million litres of water we are already saving each day.

By planning so far in advance we can find the most sustainable long-term options to meet the demands of both our existing and our anticipated new customers. Our planning supports the ‘twin track’ approach to ensure that we adopt the best options to manage both customer demand for water and the development of the most sustainable sources of supply.

We consult with our customers and stakeholders to produce these plans which are prepared every five years.

Managing water demand through leakage, metering and water efficiency innovations (which are delivered in partnership with any retailer) form a key plank of both our wholesale plan and our longer-term strategy to ensure there is sufficient water to meet demand.

Our Customer Metering Programme has been a real success story – we are on target to have installed 175,000 meters by 2015. This has been supported by a comprehensive customer and stakeholder communication programme that has resulted in an increased understanding of why metering is needed and praise for how the programme is being delivered.

We believe that provision of water through a meter is the fairest way to charge for water, recognising the importance of making sure we protect vulnerable customer groups. Metering helps customers to understand their water usage and make their own choices around water efficiency and the amount of water they use.

Metering remains a key tool to help reduce demand for water and so forms a key component of our 2015 to 2020 wholesale business plan. We will invest £50.3 million installing a further 174,000 meters so that by 2020 over 90% of households will have a meter.

Strategic report

We have determined the impacts that our metering work will have on water use and are forecasting that customers' use of water will reduce from 165 litres per person per day to 148 litres per person per day by 2040.

Ensuring water quality

The taste, colour and hardness or softness of our water depends significantly on the source of water supply. Two-thirds of our water comes from underground aquifers while the remainder comes from rivers and reservoirs.

The quality of the drinking water we supply is monitored at every stage of the treatment process through to when it flows from our customers' taps.

We take samples every day, which are analysed in our state of the art laboratory to ensure that the water is safe to drink and that we are complying with the Water Supply (Water Quality) Regulations 2000 (as amended 2007). We must supply water that complies with these regulations, exceeding these standards where possible.

The quality of water for domestic purposes is also monitored by the independent Drinking Water Inspectorate.

Our Customer Code of Practice leaflets provide further information as follows:

- South East Water: Your water company;
- Water Metering: A guide for household customers;
- Household water charges, payment options and debt recovery;
- Leakage from customers' supply pipes;
- Service Plus: Our services for customers with additional needs;
- Guaranteed standards of service; and
- What do I do if I have a complaint?

Our Business Plan

Every five years we consult with our customers to help us develop our priorities for the next five year period. In December 2013 we submitted to Ofwat our latest Business Plan, which sets out how we intend to maintain and improve our services for our domestic and commercial customers between 2015 and 2020.

Customer feedback has played a crucial role in shaping our plans, and our goal is to continue to meet our customers' priorities: clean water, low leakage, effective service, affordable bills and reliable supplies. In addition, we have set ourselves a significant challenge to be more efficient in the way that we run our business.

Our proposed plan to the water industry regulator, Ofwat, is to invest £475 million over the next five years, which represents over £500 for every home and business that we supply. This represents an increase of 6% compared to our current level of investment.

We have been engaging with household and business customers, key stakeholders and the South East Water Customer Challenge Group, about any changes that we may need to make to our plan and the impact they will have on customers' future water supply service and the level of water bills.

Our Business Plan was submitted in December 2013 and further evidence was presented at the end of June 2014. We now await the results of the review by Ofwat who will issue a final determination in December.

Our dedicated webpages summarise the plan at www.southeastwater.co.uk/businessplan.

Strategic report

Our prices

Through our water bills we reflect the cost of abstracting, treating and transporting water to our customers.

The price of water that we charge our customers is regulated by Ofwat as part of the five year price review. In determining prices, Ofwat makes a number of assumptions with regard to required investment levels, the appropriate cost of capital and operational costs. The risk of variations in these assumptions is mitigated by South East Water as far as possible but, to a significant extent, we carry the risk of such variations until the next price review.

The next price review is due to be concluded in 2014, with prices being determined with effect from April 2015.

The overall price increase allowed by Ofwat for the 2013/14 year was 4.6% which included an allowance for RPI of 3.0%. Underlying demand has fallen for a third year and in addition we are receiving less revenue from our newly metered customers as they are beginning to see the financial benefit of having had a meter installed. After allowing for the price increase in our tariffs set down by Ofwat and the reduction in consumption by our customers, the overall increase in water revenue was 2.7%.

Social tariffs

With many household bills going up, we know that for some of our customers water bills are hard to afford.

We do as much as we possibly can to help by offering a range of tariffs for those customers with particular water needs, flexible payment plans and financial assistance through our charitable trust, Helping Hand.

We also work closely with Citizens Advice Bureau staff to share good practice in debt management and understand the potential implications of welfare reform on customers' ability to pay our bills.

We have taken a further step to address affordability by introducing a new Social Tariff as part of our 2015 to 2020 Business Plan and intend for this to be available from April 2015.

In doing so, we have balanced our desire to help individual customers who have difficulty paying their water bill in full, with the interests of all our other customers.

Charges Scheme

We want to ensure the bills our customers receive for their water services are accurate and easy to understand.

In 2013 we redesigned our bills to help make them clearer for our customers. We also publish information on our website to help customers find out how their bill is calculated and how it pays for our services.

The latest charges scheme for metered, unmetered and assessed bills can be found on our website, where there is also a postcode checker which allows customers to quickly check their charges.

Capital investment

Capital investment in the year was £99.6 million with our cumulative expenditure for the first four years of the regulatory period now exceeding Ofwat's final determination by £18 million. We expect to continue to exceed the final determination targets in the final year of the regulatory period, underlining our commitment to ensure the capability of our assets meets the service levels our customers demand.

We continue to work with our strategic partners, Jacobs, to deliver our capital programme and are confident that we will deliver the remainder of our regulatory and customer commitments by March 2015.

During the year we have invested £38.0 million on developing and improving our above ground assets (treatment works, service reservoirs and pumping stations) and a further £27.9 million on renewing and replacing our underground mains infrastructure (the pipes that transfer water to our customers).

Strategic report

As part of our strategic objective to improve our water resource supply and demand management, we plan to have 90% of our household customer base on metered supply by 2020 and we have invested £12.4 million on meter installations during the year, installing over 52,000 new water meters. As at March 2014 62.4% of our domestic customer base is on a metered supply.

We continue to invest in our water treatment works to improve the quality of our water and as such invested approximately £15.1 million in refurbishing our treatment works.

Financial Performance

There are a range of financial performance indicators that we use to monitor the business. These are linked to the key strategic financial requirements of our licence of appointment and those of our investors and they underpin the capital structure of the Company and the financial governance that we apply to our business.

Under our licence of appointment which has been granted by the Secretary of State, we are required to maintain investment grade ratings and are currently rated BBB with Standard and Poor's and Baa2 with Moody's. Our Financial performance targets support these ratings and we review our indicators regularly to ensure that we are on track to maintain compliance. Equally important are the requirements of the securitisation underlying the capital structure of the business. The maintenance of the financial covenants set out under our loan documentation is essential for the continued support of our bond investors.

We manage our capital structure in a way that enables us to maintain our investment grade credit rating and comply with our loan covenants. We monitor interest cover ratios and the ratio of net debt to Regulated Capital Value. This is monitored continuously to ensure covenant compliance both in the current reporting period and future reporting periods.

The returns to shareholders and bondholders of the business are determined by the cost of capital allowed by Ofwat in the Price Review process and this is measured closely.

The amount of capital expenditure that the business makes is set down in the Price Review which is set by Ofwat.

In addition, we monitor profitability, capital expenditure and cash performance, further details of which are set out in the table below.

KPI	Measure	2013/14	2012/13
Credit Rating	*Standard & Poors*	**BBB**	BBB
	Moodys	**Baa2**	Baa2
Gearing	*%*	**81.0**	78.7
Interest Cover		**3.7**	3.99
RCV	*£m*	**1,088.9**	1,039.4
Turnover	*£m*	**213.6**	207.9
Profit Before Tax	*£m*	**51.4**	41.6
Capital Expenditure	*£m*	**99.6**	92.4
Cash	*£m*	**52.7**	99.5

The Group financial statements are set out on Page 37 and they together with the accounting policies and notes to the Group accounts summarise the financial performance of the business. The Group accounts are prepared under International Financial Reporting Standards (IFRS) and report the results for the consolidated South East Water Group. The Group accounts include the results of South East Water (Finance) Limited. The financial performance of the South East Water Limited company are summarised on pages 78 to 106 and are prepared under UK GAAP.

Strategic report

The turnover for the year was £213.6 million compared to the previous year of £207.9 million. The increase in revenue includes an increase of 1.6% as allowed by Ofwat in the Price review and an allowance for inflation of 3.0%.

Our operating costs for the year have increased from £112.6 million to £122.9 million. This increase of £10.3 million is due to there being a prior year one off exceptional credit of £4.2 million in respect of the closure of the pension scheme which was not repeated in the current year, together with an increase in power costs of £2.3 million, an increase in depreciation on our asset base of £1.8 million, a bad debt charge increase of £1.1 million. Various other smaller increases relating to contractor costs and rates amounted to £1.0 million

Group operating profit of £96.2m reflects a similar underlying profit performance as 2012/13 although the prior year additionally benefited from the exceptional pension curtailment gain. Profit before tax has increased from £41.6 million to £51.4 million. The main reason for the increase in profitability is the reduction in finance costs from £64.6 million to £50.0 million. The movement in finance costs is principally due to the reduction in the non-cash adjustment required to reflect the fair value of our interest rate swap. The adjustment to the fair value of the swap in the year was £1.1 million.

The cash flow statement on page 41 shows a reduction in the cash balance of £46.8 million to £52.7 million at the year end. Owing to the significant capital expenditure program throughout the price review period, our business, as with other companies in the water sector, is cash negative. With capital expenditure of £99.6 million in the year, the reduction in cash is in line with expectations.

Dividends paid in the year were £30.0 million and were in line with our plans.

There have been no new loans made or bonds issued in the year. Our business plan which has been submitted to Ofwat sets out our funding requirement for future years.

From the table above, the gearing level of 81.0% is less than the “lock up” covenant of 85% and the interest cover ratio at 3.7 is comfortably above the trigger mark of 1.4 as set out under our Finance securitisation structure.

Principal Risks and Uncertainties

The Board is responsible for South East Water’s risk management processes. These risks and processes are constantly reviewed for effectiveness by the Board and the management team.

The risks together with the mitigating actions taken by the business are set out below

Non Financial risk

Changes to the regulatory environment

The price review which sets water prices for the five years from April 2015 to March 2020 is due to be concluded by December 2014. Ofwat have adopted significant changes in their approach to regulation for this review including the production of three individual plans for the wholesale business and each of the contestable and non-contestable retail businesses.

Climatic changes

Our water resources are determined by the weather with 75% of our supply from underground aquifers and the balance captured above ground in rivers and reservoirs. The variation in weather patterns have been incorporated into the Water Resources Management Plan and as part of our medium- to long-term strategy we are focusing on strengthening our water resources whilst at the same time promoting water efficiency with our customers.

Water Framework Directive

The Water Framework Directive (WFD) requires all inland and coastal waters to reach ‘good status’ by 2015 and sets a framework which aims to provide substantial benefits for the long-term sustainable management of water.

Strategic report

This Directive has the potential to drive major additional capital investment and increases in customers' charges. The Final Business Plan which is the basis for the next price review incorporates projects necessary to ensure compliance with the WFD.

Water industry competition and development of the abstraction regime

The Water Act 2003 and the Water Act which received Royal Assent in May 2014 both seek to increase the level of competition in the industry. As part of these measures, the threshold for non-household customers to be able to choose their water supplier has been reduced from 50 ml per annum to 5 ml per annum and by 2017 all non-household customers will be able to choose their supplier.

A number of other measures have been included in the Water Bill with a view to expand the water supply licensing regime. A new retail infrastructure authorisation will replace inset appointments for supplies to new developments removing the need for new entrants to obtain an inset appointment for each site.

The Water Bill also provides for a new wholesale and retail pricing regime. These changes will mean that South East Water is vulnerable to loss of non-household customers to both other water companies and to new entrants and will inevitably be exposed to increased costs as market mechanisms are developed.

Supplier markets

We are subject to external market forces, where input prices can sometimes rise beyond the regulatory allowance. As part of our procurement strategy, contracts are tendered and negotiated on a regular basis which ensures that all aspects of the cost base are continually reviewed. This allows the business to mitigate exceptional increases arising in the market. The risk of increase of power costs is mitigated by forward contracts agreed with our supplier.

Treasury management and financial risk

We have a significant capital programme which requires capital investment from the financial markets. The main risks arising from the our activities from a financial perspective are interest rate risk, cash flow risk, credit risk, liquidity risk, counterparty risk, price risk and capital management.

Interest rate and cash flow risk

We finance our activities through a mixture of cash generated from operations and various long and short term loans which are set out in the Notes 19 to 22 of the consolidated accounts. We mitigate the risk of fluctuating interest by fixing the interest rate applied to its borrowing for set periods of time both for the short term and for the long term

Credit risk

Our credit risk is primarily attributable to our trade receivables. These are stated in the balance sheet at original invoice amount less an allowance for doubtful debts. We have no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

Liquidity risk

We aim to maintain a balance between cash from ongoing operations and access to longer term funding. Short-term flexibility is achieved by varying the amounts drawn down under short-term facilities. Further details are given in note 19 and 22. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

Counterparty risk

Counterparty risk is the risk of financial loss if a counterparty to a financial instrument fails to meet its contractual obligations and arises principally from our receivables from cash on deposit and the mark to market position from the counterparty to the inflation swap. Under the terms of our treasury policy, financial counterparties have to meet minimum credit rating criteria assigned by either Moody's or Standard & Poor's. There is also a mechanism for the swap counterparty to post collateral or be replaced if the counterparty drops below the minimum credit rating threshold.

Strategic report

We operate a diversified cash management policy, placing cash deposits with several different financial institutions that have a strong short-term credit rating.

Price risk

The price of water that we charge is regulated by Ofwat as part of the five year price review. The price increases (or decreases) in line with RPI and an adjustment is allowed under the licence ("k"). This latter adjustment is determined as part of the Regulatory Price review by Ofwat.

Capital Management

The primary objective of the our capital management is to ensure that the Company maintains an appropriate credit rating and healthy financial ratios in accordance with covenants stipulated in the our financing documents as agreed with all financing parties. We manage our capital structure and make adjustments as required, taking into account the delivery of the capital programme and economic conditions. To change or adjust the capital structure, we may adjust the dividend payment to shareholders or borrow additional capital from the money markets.

We monitor interest cover ratios and the ratio of net debt to Regulated Capital Value. This is monitored continuously to ensure covenant compliance both in the current reporting period and future reporting periods.

Our Assets

Our assets are the most vital element of our 24-hour water supply service. Keeping such an extensive network of pipes, pumping stations and treatment works running smoothly to produce reliable, high quality water supplies, requires the right investment at the right time. The way we do that is by assessing the health of our assets which should be stable enough to deliver expected levels of service for many years ahead. This investment in asset maintenance, which we have secured in previous price reviews, has delivered clear benefits. Some 15 years of consistent investment (of approximately £350 million) means our above ground assets are in good shape and their performance has been assessed as being stable.

However, we still have some way to go to achieve consistency in the stability of our below ground assets. Although they are currently assessed as being stable, they remain extremely vulnerable to extremes of weather.

We decided to invest more on below ground maintenance than was actually allowed in our prices for 2010 to 2015 so these critical assets can return a stable performance, and we can be confident of maintaining levels of service.

Water Framework Directive

The Water Framework Directive aims to improve water quality and biodiversity by ensuring the effective management of river catchments. Although demanding, we are committed to playing our part, working with others to address any problems at source so that drinking water quality standards are achieved. One important vehicle is the National Environment Programme (NEP).The NEP is a statutory-driven programme established by the Environment Agency and Natural England to ensure we meet our obligations under the Water Framework Directive.

Between 2010 and 2015 we have been carrying out six schemes under this programme to monitor our impact on the environment. There is more detail on this within our Environment and Social Achievements report which is available on our website www.southeastwater.co.uk.

Climate Change

One factor that will impact the way we work and what we do is climate change. We anticipate an environment where climate change sees drier hotter summers and wetter milder winters, coupled with greater extremes of weather events.

Strategic report

As a water company operating in the South East of England we are acutely aware that it will be increasingly difficult to achieve high standards of service unless we implement plans and strategies now that will enable us to adapt to these changes.

We are already seeing the impact of climate change on our water sources, which subsequently impacts our customers' use. Whilst we continue to focus on encouraging the efficient use of water to reduce demand, we need to develop ways to reduce our wider impact on the environment, impacts that are also contributing to climate change.

An area we will work on is our carbon emissions. As an industry we are responsible for approximately 1% of greenhouse gas emissions. As a company we produce in excess of 48,000 tonnes of carbon per year.

We are committed to reducing our carbon emissions by reducing the amount of power we use. The abstraction, treatment and distribution of water through our system uses approximately 100m kW per year. This power usage accounts for approximately 15% of our operating budget so a reduction will not only help the environment it will also help to reduce prices for our customers.

We will review and assess our processes with a view to moving towards a more sustainable approach.

We have also been using a cost benefit approach to appraising all new investment which includes an analysis of the carbon footprint. This approach takes account of power usage/carbon emissions when looking at different options for a project.

As well as trying to reduce our own impact on climate change, we are also preparing for the effects it could have on our business. Therefore in addition to general maintenance of our assets, we also need to protect them from flooding. The Environment Agency updates us regularly on the risk posed to our assets, and the latest position is that we have 93 separate assets at 55 different sites that are potentially at risk of flooding. That could impact on both the quality and reliability of the water we provide to the businesses and their customers, and so will need further investment in mitigation measures such as raising electrical equipment, installing flood-proof doors, and improved drainage to reduce this risk.

Competition

We support the introduction of competition where the results benefit customers and it does not impact on our ability to deliver the quality service our customers expect.

Our latest Business Plan acknowledges and embraces the legislative and regulatory changes that are likely to occur as a result of the government's new Water Act.

The Act, granted Royal Assent in May 2014, will introduce competition in the water sector for business customers by 2017. As a result, our Business Plan (2015-20) reflects the changing shape of the sector and puts the right preparatory processes in place, ready to meet those challenges.

By order of the Board

Paul Butler
Managing Director
4 July 2014

Our Directors

Gordon Maxwell, Chairman
Gordon has a wide range of senior executive and managerial experience gained at Thames Water, where he was Managing Director, Mid Kent Water where he was Chairman and at Courtaulds plc.

Paul Butler, Managing Director
Paul has a wealth of water industry experience, including most recently serving as Managing Director of Mid Kent Water from 2001 to October 2006. A Chartered Accountant, he previously worked for Mid Kent Water as Group Financial Controller, Ernst & Young and Marks and Spencer.

Jo Stimpson, Finance Director
Jo, a Chartered Accountant and a law graduate, was Finance Director at Mid Kent Water from August 2003 until October 2006. She has also held a number of senior management posts in finance, including those at Charteris and ICL.

Paul Seeley, Operations Director
Paul has more than 30 years' experience in the water industry, most recently serving as Managing Director of Mid Kent Water from October 2006 to December 2007. A Chartered Environmentalist, he previously worked for Mid Kent Water as Asset Director. Prior to this he has held posts with Southern Water, Severn Trent and North West Water.

Steve George, Customer Services Director
Steve is a customer services specialist with over 25 years' experience in the water industry. He was previously managing consultant at SECOR Consulting, a specialist customer management consultancy. At SECOR he had been working with South East Water for some time. Prior to this Steve held a number of senior IT and customer service roles in the water industry.

David Hinton, Asset and Regulation Director
David has more than 17 years' experience at South East Water with a Masters in Business Administration. His most recent post as Head of Assets and Economic Regulation follows a number of roles within the Company including Head of Water Quality and Head of Business Planning as well as experience elsewhere within scientific consultancies and the Public Health Laboratory Service.

Valeria Rosati, Non-executive Director
Valeria is an Executive Director at Hastings Funds Management (UK) Ltd and was appointed to the South East Water Board in December 2007. She is involved in the origination and execution of investment opportunities and the management of portfolio companies in the UK and Europe. She holds a degree cum laude in Business and Economics from L.U.I.S.S. University in Rome, and was heavily involved in both the acquisition of South East Water and the subsequent Competition Commission process in relation to its merger with Mid Kent Water.

Jean Pierre Ouellet, Non-executive Director
Jean Pierre retired from RBC Capital Markets, the investment banking arm of Royal Bank of Canada, in October 2008 where he was vice-chairman with responsibility for the firms' activity in Quebec since 2000. Prior to that he was Senior Vice President, Chief Legal Officer and Corporate Secretary of Canadian National Railway starting in 1996. Before this he practiced law with the Canadian based international law firm Stikeman Elliott. Since retiring from RBC Capital Markets, Jean Pierre has served on a number of public and private boards including Caisse de dépôt et placement du Québec (March 2009 to March 2013).

Peter Dixon, Non-executive Director
Peter was appointed Non-Executive Director to the Board of South East Water in 2014. Peter brings with him extensive experience acquired in the gas and water UK utilities as a CEO and Board member. He was an executive director responsible for gas and water assets of East Surrey Holdings Plc, a FTSE 250 business. Peter is currently Group Chief Executive Officer of Phoenix Natural Gas a gas utility and service group in Northern Ireland and a director of Four Seasons Healthcare. He has had experience of working with Terra Firma Private Equity and at Plc Board level.

Patrick Côté, Non-executive Director
Patrick is Director of Asset Management at CDP Capital France (a subsidy of Caisse de Dépôt et Placement du Québec). He was appointed as a Non-Executive Director to the Board of South East Water in 2014. Patrick brings with him vast experience in the infrastructure sector and corporate finance. He has been involved in the management of regulated assets involving various regulators in America and Europe.

Our Directors

Graham Setterfield, Independent Non-executive Director
Graham was appointed to the South East Water Board in December 2007 and previously served as Chairman of Mid Kent Water. Graham has also chaired the Institution of Civil Engineers Water Board. A former deputy managing director of Southern Water, Graham most recently worked at Water UK where he was Director of Water Services.

Emma Gilthorpe, Independent Non-executive Director
Emma has a prestigious national and international career working in the telecoms and airport industries. Currently working as Regulatory Director at Heathrow Holdings Ltd, Emma was previously BT plc's Group Director of Industry Policy and Regulation. She has also held a number of other senior regulatory and public policy roles in Cable and Wireless.

Paul Rich, **Independent Non-executive Director**
Paul has 25 years' experience working in the national services businesses. Paul was Chairman of NHS Business Services Authority and was previously Royal Mail plc's Deputy Managing Director and Marketing Director. He has also held a number of other senior management roles within Post Office Ltd.

Corporate Governance Report

Chairman's statement

The Company operates as a Water Undertaker under an Instrument of Appointment (the "Licence") issued pursuant to the Water Industry Act 1991. Under its Licence, the Company is required to conduct its regulated business as if it were a separate public limited company and in doing so is required to have particular regard, amongst other factors, to the principles of good governance set out in the UK Corporate Governance Code (the "UK Code") as issued by the Financial Reporting Council in September 2012.

The Company has also adopted its own Corporate Governance Code on 26 March 2014 (the "SEW Code"). The SEW Code incorporates into a single document the principles of corporate governance set out in the Licence, the UK Code of September 2012, the Disclosure and Transparency Rules of the Financial Conduct Authority Handbook which can reasonably be applied to a privately owned company and Ofwat's principles of leadership, transparency and governance published in January 2014 (the "Ofwat Principles"). The Company has adopted and published on its website the SEW Code and an implementation plan that will achieve compliance with the SEW Code by 1 April 2015.

The Board is structured, managed and its performance measured to ensure that the role of the Board and its effectiveness complies with the highest standards of corporate governance, with a particular emphasis on the key principles of accountability, transparency, probity and focus on the longer term and the sustainable success of the Company.

This corporate governance statement follows the structure and sequence of principles of the SEW Code (which itself closely follows the structure and sequence of principles of the UK Code) and sets out how the Company complies with the principles and provisions of the SEW Code. This statement also includes the relevant information required to be included in the annual report by the UK Code and the SEW Code. Each section below includes at the end a reference to the relevant principles and provisions of the SEW Code and to the corresponding principles and provisions of the UK Code. The SEW Code is available on the Company's website: http://www.southeastwater.co.uk/media/5260/SEW_CORP_GOV_CODE_Rev01.pdf

Where there is divergence between any of the corporate governance principles and provisions referred to above and the actual practice of the Company, this statement explains how the Board reconciles these differences. Where specific characteristics of the Company justify following an alternative to a provision the Board seeks to achieve an equivalent outcome and this statement explains clearly and carefully how the Board's actual practices are both consistent with the principle to which the particular provision relates and how they contribute to good governance.

Leadership

The Role of the Board

The Board and its committees have overall responsibility for the management of the Company and its regulated business. They make strategic decisions and provide leadership for the long term success of the Company.

It is the Board's responsibility to promote good corporate governance within a framework of effective controls, enabling risks to be managed and to ensure that the necessary financial and human resources are in place for the Company to meet its objectives. The Board ensures that the Company's statutory and regulatory obligations to its customers, shareholders, regulators, other stakeholders and the environment are met. It provides direction for management and reviews management performance.

The Board has adopted a formal schedule of matters specifically reserved for it which is published on the Company's website. These include strategy and leadership, structure and capital, financial reporting and controls, risks and internal control, business plan and other key regulatory submissions, Board policies, Board and other key appointments, directors' remuneration, corporate governance, major contracts and distributions and dividend policy.

There is a remuneration and nomination committee which reviews the remuneration of directors and all proposed appointments to the Board. The committee is chaired by Graham Setterfield, an independent non-executive director.

Corporate Governance Report

Matters which are not reserved to the Board and delegated to management are reviewed regularly by the Board through regular reporting and specific updates. The main decisions delegated to management are taken after consideration by an executive committee which is composed of all the executive directors. The Company has also created several steering groups which deal with key risk management and compliance aspects of the business.

The Board schedules regular meetings throughout the year and will also meet on an ad hoc basis to discuss other matters as needed and it is satisfied that it is able to discharge its duties effectively.

During the period 1 April 2013 to 31 March 2014, the Board met on14 occasions. The attendance of the directors was as follows:

Director	Number of meetings attended	Appointment/Resignation
G W Maxwell	14	
P Butler	14	
J E Stimpson	14	
P Seeley	12	
D G Shore	2	Resigned 17 June 2013
S George	14	
D Hinton	12	Appointed 1 June 2013
V Rosati	13	
K Bhatia	5	Resigned 19 November 2013
J-E Leroux	12	Resigned 26 February 2014
JP Ouellet	8	Appointed 25 July 2013
P Dixon	2	Appointed 27 February 2014
P Côté	2	Appointed 27 February 2014
G H Setterfield	14	
E Gilthorpe	12	
P Rich	14	Appointed 25 April 2013
R Weeden	0	Resigned 25 April 2013

The Company maintains appropriate Directors and Officers Insurance cover and has issued Indemnity Letters to each Director.

The Board complies with principles 1.1 and 1.2 of the SEW Code and related provisions. This ensures compliance with principle A1 of the UK Code and all related provisions. The Board has not adopted a standalone set of values as referred to in provision 1.2.4 of the SEW Code but has recorded the fundamental values it promotes in the Codes Objectives of the SEW Code.

A statement of directors' responsibilities in respect of the financial statements is set out on page 34 and the responsibility of our auditor is set out in the independent audit report. A statement of Going Concern is given on page 32.

Division of responsibilities

The role of chairman and managing director is not exercised by the same person. There is a clear division of responsibilities between the chairman and the managing director and this is set out in writing.

The Board complies with principle 1.3 of the SEW Code and related provisions. This ensures compliance with principle A.2 of the UK Code and all related provisions.

The Chairman

The chairman, who is a non-executive director, is responsible for the leadership of the Board and for its effectiveness. He sets the agenda for the Board and ensures that adequate time is allocated to agenda items. He is responsible for the culture of the boardroom which is one of openness and debate ensuring, in particular, the effective contribution of non-executive directors. He ensures that the information the directors receive is appropriate, prepared to a high standard and timely.

The chairman is not a former managing director or executive of the Company.

Corporate Governance Report

The chairman met the independence criteria of the UK Code on appointment and the Board is satisfied that he continues to satisfy these criteria and in particular is not linked to any shareholder. The Board has given specific consideration to the length of the appointment of the chairman which is greater than 9 years and is satisfied that the chairman remains independent of judgement and character.

The Board complies with principle 1.4 of the SEW Code and related provisions. This ensures compliance with principle A.3 of the UK Code and related provisions.

Non-executive Directors

The Board includes the chairman and seven non-executive directors, four of whom are shareholder nominated directors and three of whom are independent directors as required by the Company's Licence. The proportion of non-executive directors ensures that they are able to provide appropriate challenge and to contribute to strategy.

The non-executive directors monitor the performance of the executive directors and formal reviews against objectives are undertaken by the nomination and remuneration committee.

The non-executive directors satisfy themselves of the integrity of financial information and financial controls through regular monthly reporting and the budget approval process. The Company's auditors also attend two full Board meetings to report on the audit and their findings, and directors have direct access to the auditors. The Board reviews the Company's risk matrix twice a year and receives reports on the Company's performance and compliance with its obligations through monthly reporting and annually.

The nomination and remuneration committee determines the appropriate level of executive directors' remuneration and reviews all proposed appointments and makes recommendation to the Board in respect of all appointments. The committee's role also includes reviewing the Company's approach to succession planning.

The chairman meets with the non-executive directors without the executives being present at least 6-monthly and the independent non-executive directors meet without the chairman being present at least annually.]

The Board complies with principle 1.5 and related provisions of the SEW Code. This ensures compliance with principle A.4 and related provisions A4.2 and A.4.3 of the UK Code.

The Board has not appointed a senior independent non-executive director as required by provision A.4.1 of the UK Code (and this requirement was not incorporated into the SEW Code) but the objectives of this provision are otherwise met. The nature of the experience of other Board members is such that the chairman can use all directors and in particular independent non-executive directors as a sounding board depending on the particular matter at issue. The Board also endeavours to reach unanimous decisions and all directors are encouraged to contribute and their views are duly considered and taken into account. Similarly, the presence of four shareholder nominated directors on the Board removes the necessity for a senior independent director to act as an alternative channel of communication for shareholders.

Effectiveness

The Composition of the Board

The Board members have the appropriate balance of skills, experience, independence and knowledge of the Company to ensure that they are able to discharge their duties and responsibilities effectively.

The Board comprises the chairman, three independent non-executive directors (as required by the Licence), four shareholder nominated non-executive directors and five executive directors. Two of the shareholder nominated directors, Peter Dixon and Jean-Pierre Ouellet, are external appointees who are not employees of any shareholder. Although they have been nominated by shareholders for appointment and therefore do not satisfy the criteria of independence contained in the UK Code, they are able to exercise independence of judgement and character.

Corporate Governance Report

There is an appropriate balance between executive and non-executive directors and the number and quality of independent directors ensures that no single group or individual can dominate the Board's decision making.

The biographies on pages 16 and 17 demonstrate the calibre and range of experience of the non-executive directors which enable them to bring independent judgement on issues of strategy, performance and standards of conduct which is vital for the success of the Company. The size of the Board is believed to be appropriate in that it ensures a variety of views and experience to meet the requirements of the business and is such that changes to the Board can be managed without disruption.

The nomination and remuneration committee includes all non-executive directors and is chaired by an independent non-executive director. No person other than the chairman and other members of the committee is entitled to be present at a meeting of the committee except at the invitation of the committee. The committee has been refreshed in the period through new non-executive director appointments.

The independent non-executive directors are Graham Setterfield, Emma Gilthorpe and Paul Rich. Graham Setterfield and Emma Gilthorpe served throughout the year ended 31 March 2014. In April 2013 Robert Weeden resigned from the Board and was replaced as an independent non-executive director by Paul Rich who was appointed on 25 April 2013.

Graham Setterfield has been a director of the Company for five years and was previously a director of Mid Kent Water Ltd, which merged with South East Water in 2007. Graham was first appointed to the Mid Kent Water Board in 2001. Graham's extensive experience in the water industry, together with his independence of mind ensure that Graham is independent of shareholders and management and meets the criteria for independence set out in the UK Code. The Board has given specific consideration to Graham's length of appointment which is greater than 9 years and is satisfied that he remains independent of judgement and character.

Emma Gilthorpe is Director of Regulation at Heathrow Holdings Ltd which is part owned by Caisse de dépôt et placement du Québec (CDPQ) which is also one of the ultimate shareholders of the Company. Emma was recruited via an external recruitment process and brings with her extensive experience of other regulated sectors. She does not in any way represent the views of CDPQ on the Board. She is independent of shareholders and management and fully meets the criteria for independence set out in the UK Code.

Paul Rich has 25 years' experience working in national services businesses. Paul was Chairman of NHS Business Services Authority and was previously Royal Mail plc's Deputy Managing Director and Marketing Director. He has also held a number of other senior management roles within Post Office Ltd. He is independent of management and shareholders and fully satisfies the criteria of independence set out in the UK Code.

The Board complies with principle 2.1 of the SEW Code and related provisions except provisions 2.1.3, 2.1.4 and 2.1.5. This ensures compliance with principle B.1 of the UK Code and related supporting principles and with provision B.1.1.

The Board does not currently comply with provisions 2.1.3, 2.1.4 and 2.1.5 of the SEW Code which relate to the composition of the Board and require in particular that independent directors are the largest single group on the Board. The implementation plan of the SEW Code includes steps to amend the composition of the Board by appointing an additional independent non-executive director and reducing the number of executive directors to three which will achieve compliance with these provisions.

Appointments to the Board

Other than for internal candidates for executive positions who have been identified through the Company's succession planning, all recruitment to the Board is carried out by a formal, rigorous and transparent procedure using an external search firm. Role requirements are subject to detailed specifications and appointments made on merits. The recruitment is carried out with due regard for the benefits of diversity on the Board, including gender, skills and experience. The Board has a written diversity policy which is published on the Company's website.

Corporate Governance Report

The terms of reference of the existing remuneration committee were extended on 24 October 2013 to create a new remuneration and nomination committee which leads the process for Board appointments and make recommendations to the Board for all new appointments. The terms of reference of the remuneration and nomination committee are available on the Company's website and reflect the requirements of the UK Code relating to nomination committees. This includes a duty to review the Company's succession planning for the Board and senior management. The members of the remuneration and nomination committee are the three independent non-executive directors one of which is chairman of the committee, the chairman of the Board who is not the chairman of the committee and the four shareholder nominated directors. The committee does not have a majority of independent non-executives directors and therefore its composition does not comply fully with provision 2.2.4 of the SEW Code. However, the Board considers that the balanced representation between independent non-executive directors and the independent chairman on the one hand and the four shareholder nominated directors on the other hand ensures that the committee can operate effectively having regard in particular to the fact that the Company is not listed. The implementation plan of the SEW Code includes steps to achieve full compliance with provision 2.2.4 by 30 September 2014.

The term of the appointment of independent non-executive directors is 3 years and any continuous term beyond 6 years is subject to rigorous review.

During the year the Board recruited one independent non-executive director. Role specifications were produced by the chairman and managing director who together led the recruitment process on behalf of the Board. The external search firm used was Odgers Berndtson. Following interviews the selected candidates were informally interviewed by the shareholder appointed Directors and met the independent non-executives in an informal setting. Following appropriate feedback from these meetings the appointment was made.

The remuneration and nomination committee has met 6 times in the year ended 31 March 2014. Since October 2013, the committee has scrutinised the appointment of two shareholder nominated directors and made recommendations to the Board in accordance with its terms of reference.

The remuneration and nomination committee was chaired by Graham Setterfield. The other members were Gordon Maxwell, Emma Gilthorpe, Paul Rich, Valeria Rosati, Kanishk Bhatia (until his resignation), Jean-Etienne Leroux (until his resignation) and Jean-Pierre Ouellet. Patrick Côté and Peter Dixon became members of the remuneration and nomination committee on their appointment to the Board.

The role and responsibilities of the remuneration and nomination committee include:

- to regularly review the structure, size and composition of the Board and make recommendations to the Board;
- to consider succession planning for directors and other senior executives, keep under review the leadership needs of the organisation;
- to be responsible for considering new appointments for the approval of the Board and for considering candidates presented for nomination by shareholders, and evaluate the balance of skills, knowledge, experience and diversity on the Board;
- to review the results of the Board performance evaluation process that relate to the composition of the Board;
- to make recommendations to the Board concerning plans for succession for both executive and non-executive directors and in particular for the key roles of chairman and chief executive and in respect of talent management and membership of any other Board committees.

The Board complies with principle 2.2 of the SEW Code and related provisions except 2.2.4 as explained above. This ensures compliance with principle B.2 of the UK Code, related supporting principles and all related provisions except provision B.2.1 due to the composition of the remuneration and nomination committee as explained above.

Commitment

Sufficient time is available both for the executive and non-executive directors to undertake their responsibilities.

The chairman does not have any other significant commitment that would be required to be included in this statement.

Corporate Governance Report

The expected time commitment is reviewed as part of the appointment process of non-executive directors including the requirement for additional commitment outside scheduled Board meetings when required.

A defined expected time commitment is not set out in the terms of appointment of non-executive directors as set out in provision 2.3.2 of the SEW Code, instead, and to reflect the need for sufficient flexibility, the terms of appointment of non-executive directors include an undertaking that the non-executive director is able to allocate sufficient time to discharge his or her responsibilities efficiently, taking account of other commitments. This achieves the objective of provision 2.3.2 in a different way.

Directors disclose their other commitments at the time of appointment. An update of each director's other commitments was provided to the Board following the year ending 31 March 2014. Further updates are made as required if a non-executive director takes any additional commitment with the agreement of the Company. A non-executive director is also required to obtain prior agreement before accepting additional commitments. Executive Directors do not hold any non-executive directorship.

The Board is compliant with principle 2.3 of the SEW Code and related provisions. This ensures compliance with principle B.3. of the UK Code and related provisions for this year.

Development

On joining the Board each director receives a detailed, tailored induction programme which is supplemented as needed to ensure that the director's knowledge, familiarity with the Company and its industry, and their own capabilities are maintained at the appropriate level. The induction programme includes visits to production sites and other Company facilities away from the Company's head office and at least one Board meeting per year is held away from head office at a different Company site. Such visits give directors the opportunity to speak to a wider group of staff and contractors.

The continuous updating of skills and knowledge and familiarity with the Company is achieved through regular reporting. The chairman rviews and agrees with each director their training needs in connection with the Board evaluation process.

Non-executive directors and especially independent non-executive directors are given direct access to management as requested and to review specific areas of the business directly with management.

The Board complies with principle 2.4 of the SEW Code and related provisions. This ensures compliance with principle B.4. of the UK Code and related provisions.

Information and Support

The directors are provided with appropriate, accurate and relevant financial and operational information necessary for them to discharge their duties. The management information is prepared by the senior management of the Company and produced on a timely basis for consideration and review by the directors. Clarification, amplification and specific updates are provided as requested by directors. Senior managers periodically attend the Board to provide appropriate levels of information on key issues.

The company secretary is responsible for the provision of legal guidance and support as and when appropriate and on corporate governance matters.

All directors have access to the advice and services of the company secretary in furtherance of their duties. Directors and especially non-executive directors also have access, when necessary, to independent professional advice at the Company's expense. The right of independent non-executive directors to receive professional advice at the expense of the Company is recorded in their terms of engagement.

The appropriateness of the information received is reviewed as part of the Board evaluation process carried out annually.

The Board complies with principle 2.5 of the SEW Code and related provisions. This ensures compliance with principle B.5. of the UK Code and related supporting principles and provisions.

Corporate Governance Report

Evaluation

During the financial year 2013-14 the process of evaluation of the Board and of its Remuneration and Nomination committees has been carried out as part of a comprehensive and detailed review of corporate governance which lead to the adoption of our SEW Code. This board evaluation process considered the corporate governance requirements of the Company's Licence, the UK Code, Ofwat's principles of leadership, transparency and governance, and the Disclosure and Transparency Rules.

The board carried out a systematic review of these requirements against its existing corporate governance framework and how it operates. This review covered the effectiveness of the board, the balance of skills, experience, diversity, independence and knowledge of the Company on the board, the composition of the board including the balance between independent non-executive directors, shareholder nominated directors and executive directors and how this affects the way the board works together as a unit. It also considered the composition and role of the remuneration and nomination committee, the need for a separate audit committee, the process for the identification and management of risks, and how the board is best be able to balance the needs of customers, the environment, the business and its shareholders.

Following this review the board adopted the SEW Code with a proposed implementation timetable to achieve full compliance with the SEW Code by 1 April 2015. This includes the appointment of a new independent non-executive director, the reduction of the number of executive directors on the board, the creation of a separate audit committee, succession planning and further progressive refreshing of the board.

Although the Company would be classed as a 'smaller' company under the UK Code, the board considered whether its board evaluation should be externally facilitated and concluded that this was not appropriate having regard in particular to the extent and thoroughness of this corporate governance review, and the need to first implement the transition to full compliance with the SEW Code.

The board evaluation process also included a review of the role and independence of the chairman and of the independent non-executive directors. The evaluation of the performance of the executive directors has been carried out by the remuneration and nomination committee.

The board complies with principle 2.6 of the SEW Code and related provision subject to the explanations provided below in respect of provision 2.6.3 and 2.6.4. This ensures compliance with principle B.6 of the UK Code and related supporting principles and provisions B.6.1 and B.6.2. As stated above, the evaluation of the chairman was not carried out following the form set out in provision 2.6.5 of the SEW Code (and B.6.3 of the UK Code) which requires the individual evaluation of the chairman to be carried out by non-executive directors, as this aspect was considered as part of the wider board evaluation and the review of corporate governance carried out by the board as a whole.

Re-election

The provisions on directors' re-election for listed companies are not applicable to a private company such as the Company. Similarly principles B.7 and related provisions of the UK Code are not applicable to the Company and have not been incorporated into the SEW Code. In addition, as a privately owned Company with shareholder appointed non-executive directors who can actively input into Board appointments, Board evaluation and succession planning through the remuneration and nomination committee, the Company is able to achieve the purpose of principle B.7 and related provision by other means.

In respect of the duration of service of independent directors, two independent non-executive directors, the chairman and Graham Setterfield, have served for longer than 9 years. This has been specifically considered by the Board in relation to the adoption of the SEW Code and the associated implementation plan. The directors are satisfied that both the chairman and Graham Setterfield remain independent. However, having regard to the need for regular refreshing of the Board, the chairman after consultation has proposed that he would remain in office until no later than 1 April 2015 and that Graham Setterfield would remain in office until no later than 30 September 2015. This proposal was adopted by the Board and included in the implementation plan of the SEW Code. This is consistent with the objective of provision 2.7.1 of the SEW code (and B.7.1 of the UK Code).

Corporate Governance Report

Accountability

Financial and Business Reporting

The Board reports on the Company to shareholders annually in compliance with the Companies Act and submits Regulatory Accounts to the Water Services Regulation Authority in accordance with its Licence.

The Board is committed to achieving transparent and open reporting which is clear and accessible and in accordance with the SEW Code, this Annual Report reflects material issues including company performance, the key risk to the business and the group structure. These aspects are dealt with in our Strategic Report and Directors Report.

This Annual report is compliant with appropriate Accounting Standards and audited by the external auditor.

The Board reviews and approves the annual and interim financial statements to ensure appropriate financial, operational and performance information is communicated to the Company's wide range of stakeholders and that, taken as a whole, such reports are fair, balanced and understandable and provides the information necessary to assess the Company's performance, business model and strategy. The statement of directors' responsibilities is set out on page 34.

In preparing this this statement the Board had regard to the requirements of DTR 7.2. The requirements of DTR 7.2 are satisfied in part through compliance with similar requirements of the UK Code.

The Board acknowledge that the key drivers for maintaining and enhancing value over the longer term are maintaining and improving the Company's credibility with customers and stakeholders and the effectiveness, efficiency and innovation with which the Company is operated.

The factors that allow the Company to confirm that the business is a Going Concern are set out in the Director's report on page 32 and the independent auditor's report is set out on page 35.

The Board complies with principle 3.2 of the SEW Code and related provisions. This ensures compliance with principle C.1 of the UK Code and related supporting principles and provisions.

Risk Management and Internal Control

The Board monitors the Group's principal risks and uncertainties and these are set out in the Strategic Report (page 12). The strategic approach to risk management is determined by the Board and appropriate internal controls implemented to counter these risks.

Key features of the system of internal control include the following:

- regular Board meetings with a formal schedule of matters reserved for the Board for discussion;
- annual review by the Board of the Company's risk register and report on compliance with the Company's obligations;
- clearly defined organisation structures with appropriate delegated authorities;
- risk management procedures and framework for the identification, evaluation and mitigation of risks including regular review by executive management and reporting to the Board;
- steering groups in charge of specific aspects of the business assessing and managing relevant risks and compliance on an ongoing basis;
- policies and procedures for conducting significant aspects of the Company's activities;
- a comprehensive five year business plan and annual budget and a rigorous process of monitoring actual performance against the budget and business plan;
- through the executive investment committee, policies and procedures for the approval and control of all major items of capital expenditure and for the acquisition and disposal of material assets;
- through the Information Systems Steering Group, policies and procedures for the approval and control of all major systems and IT investment;
- policies and procedures for the approval and control of any arrangements which could give rise to a material liability for the Group; and
- Board sign-off of regulatory business plan, water resources plan, annual compliance statement and principle statement.

Corporate Governance Report

During the course of its review of the risk management and control systems, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant.

The Board complies with principle 3.3 of the SEW Code and related provisions. This ensures compliance with principle C2 of the UK Code and related provisions.

Audit committee and Auditor

The Board recognises and values the importance of the relationship with the auditor. Rather than create an audit committee the Board ring-fences part of the Board agenda at not less than two meetings of the Board to enable the entire Board to understand and discuss the auditor's approach to their audit and to receive a full debrief as to their findings. If considered necessary by either the audit partner or by the non-executive directors, part of this discussion may take place in the absence of the executive directors.

The entire Board will also review reports from management on the effectiveness of the Company's internal control systems. The Company does not have an internal audit function but internal audit activity is conducted periodically by members of management, ensuring appropriate independence from the area of the Company that is subject to review.

The current auditor was appointed in November 2010 following a procurement process. The Board satisfies itself as to the continuing independence of the external auditor. In doing so, it considered the following factors having regard to the views of management and the external auditor:

- the auditor's procedures in place for maintaining and monitoring independence including those to ensure that the partners and staff have no personal or business relationships with the Group other than those in the normal course of business permitted by UK ethical guidance;
- the auditor's policies for the rotation of lead partner and key personnel; and
- the auditor's policies providing for them to be engaged only for non-audit services which are not prohibited by professional or other regulatory requirements.

The arrangement and process described above is discussed with the auditors to confirm that this achieves the objectives of principle 3.4 of the SEW Code (and C.3 of the UK Code) and provides the level of scrutiny of the financial reporting required by this principle. The Board is satisfied that this arrangement provides the appropriate level of scrutiny and transparency and gives the opportunity for all the directors including independent non-executive directors and non-executive directors nominated by shareholders to engage directly with the auditors.

The Board achieves the objectives of principle 3.4 of the SEW Code (and C.3 of the UK Code) but does not comply with the related code provisions as it has not established an audit committee. The Board as a whole carries out the functions and activities referred to in these provisions.

The implementation plan of the SEW Code provides that the Company will establish an audit committee by February 2015.

Remuneration

The level and Components of remuneration and Procedure

The determinants of directors' remuneration are set out in the Remuneration Report on page 29.

Throughout the financial year the remuneration and nomination committee, which is chaired by an independent non-executive director, consisted of the chairman, the independent non-executive directors and the shareholder nominated non-executive directors. Other individuals including the managing director, the head of human resources and external advisers are invited to submit reports or attend all or part of any meeting as and when appropriate. The committee met 6 times during this period.

Corporate Governance Report

The role and responsibilities of the remuneration committee are:

- to determine and agree with the Board the framework or broad policy for the remuneration of the Company's Managing Director, the executive directors and such other members of the executive management as it is designated to consider. The remuneration of independent non-executive directors shall be a matter for the chairman of the Board in consultation with shareholders and the Managing Director. No director or manager shall be involved in any decisions as to their own remuneration;
- in determining such policy, to take into account all factors which it deems necessary including relevant legal and regulatory requirements, the provisions and recommendations of the UK Code and associated guidance. The objective of such policy shall be to ensure that members of the executive management of the company are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their individual contributions to the sustainable success of the Company;
- when setting remuneration policy for directors, to review and have regard to the remuneration trends across the company or group;
- to review the ongoing appropriateness and relevance of the remuneration policy;
- within the terms of the agreed policy and in consultation with the chairman and/or Managing Director, as appropriate, to determine the total individual remuneration package of each executive director and other designated senior executives with specific emphasis on the design and determination of annual performance bonuses;
- to obtain reliable, up-to-date information about remuneration in other companies. To help it fulfil its obligations the committee shall have full authority to appoint remuneration consultants and to commission or purchase any reports, surveys or information which it deems necessary, within any budgetary restraints imposed by the Board;
- to be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee;
- to approve the design of, and determine targets for, any performance related pay schemes operated by the company and approve the total annual payments made under such schemes;
- to determine the policy for, and scope of, pension arrangements for each executive director and other designated senior executives;
- to ensure that contractual terms on termination, and any payments made, are fair to the individual, and the company, that failure is not rewarded and that the duty to mitigate loss is fully recognised; and
- to oversee any major changes in employee benefits structures throughout the company or group.

The Board approves the remuneration report included in this Annual Report.

The remuneration committee was chaired by Graham Setterfield. The other members were Gordon Maxwell, Valeria Rosati, Kanishk Bhatia (until his resignation), Jean-Etienne Leroux (until his resignation) and Emma Gilthorpe. Paul Rich, Jean-Pierre Ouellet, Patrick Côté and Peter Dixon became members of the remuneration committee on their appointment to the Board. The meetings of the remuneration and nomination committee were held on 25 April 2013, 21 May 2013, 26 September 2013, 30 January 2014, 27 February 2014 and 26 March 2014 after the full Board meetings.

The terms of reference of the remuneration committee reflect the requirements of the UK Code [and are available on the Company's website].

The Board complies with principle 4.1 of the SEW Code and related provisions. This ensures compliance with principle D.1 of the UK Code and related provisions. The Board complies with principle 4.2 of the SEW Code (and principle D.2 of the UK Code) and related supporting principles and provisions subject to the following.

The Board does not comply with the requirements of provision 4.2.3 of the SEW Code relating to the composition of the remuneration committee as there is not a majority of independent non-executive directors on the remuneration committee. The implementation plan of the SEW Code provides that the Company will amend the composition of the remuneration committee ensuring compliance with provision 4.2.3 of the SEW Code by 30 September 2014.

Corporate Governance Report

The Board does not comply with the requirements of provision D.2.1 of the UK Code relating to the composition of the remuneration committee as all members of the committee are not independent non-executive directors. This requirement was not incorporated into the SEW Code which instead incorporated the requirement set out in the Ofwat Principles that there should be a majority of independent non-executive directors on the remuneration committee. However, the non-executive directors nominated by shareholders are also members of the remuneration committee which ensures that shareholders are directly involved in defining executive directors' remuneration and provides an enhanced level of control by shareholders compared to the requirement of provision D.2.1. The committee is chaired by an independent non-executive director.

The Board has exercised scrutiny on the overall level of remuneration as part of the budget approval process. The remuneration committee has reviewed the incentive remuneration package of senior management. This ensures compliance with provision 4.2.8 of the SEW Code and D.2.2 of the UK Code.

Relations with shareholders

Dialogue with Shareholders

Communication with shareholders is facilitated as the Company is a private limited company with shareholder nominated non-executive directors on the Board. The Board is accountable to the Company's shareholders and as such it is important that the Board appreciates the requirements of shareholders and equally that shareholders understand how the actions of the Board and short-term financial performance relate to the achievement of the Company's longer-term goals. The reporting calendar is dominated by the publication of interim and final results each year, in which the Board reports to shareholders on its stewardship of the Company. At other times during the year, presentations to rating agencies and updates to the stock exchange are made available to all. The chairman ensures that the managing director and finance director provide feedback to the Board following presentations to investors and meetings with shareholders.

Due to the nature of the Company as explained above, the provisions of the UK Code relating to relations with shareholders were not incorporated into the SEW Code. However, the Board achieves compliance with the objectives of principle E.1 of the UK Code and related supporting principles and provisions as there is director representation of shareholders on the Board of the Company.

Constructive use of the AGM

The Company is a private company which is not required under the Companies Act 2006 to hold an AGM. Non-executive directors appointed by shareholders sit on the Board of the company and shareholders have direct access to the executive directors and management information so that a high level of engagement and participation is achieved without holding an AGM.

The provisions of the UK Code in relation to the constructive use of the AGM were not incorporated into the SEW Code as principle E.2 and related provisions do not apply to a private company such as the Company.

Corporate Governance Report

Remuneration Report

The remuneration committee of the Board met on 25 April 2013, 21 May 2013, 26 September 2013, 30 January 2014, 27 February 2014 and 26 March 2014.

Rewards for independent non-executive directors are based on a structure of fees which are periodically compared with market practice.

Rewards for the managing director and senior executives are based on a total reward package of basic salary, performance incentive scheme and benefits sufficient to attract, motivate and retain individuals of the required calibre to lead the business. Our policy aims to be around median market practice, with a performance bonus for achieving stretching corporate, directorate and personal targets, which is sufficient to motivate strong commitment to achieving the goals set, and to establish a close link between overall rewards and corporate performance. Performance targets include improving the Company's SIM score and industry efficiency ranking, and reducing customer debt, as well as financial performance targets and meeting capital investment targets. The remuneration committee establishes corporate bonus targets at the beginning of the financial year and decides the performance bonus payment to each member of the executive team. Decisions on the pay of senior executives take into account information from independent reward surveys. The managing director and senior executives participate in the same pension schemes as other staff and do not participate in a long term incentive plan.

The Company's reward policy is to maintain a total reward package for staff throughout the business consisting of basic salary and benefits sufficient to attract, motivate and retain good quality staff. Senior managers participate in the management performance bonus scheme.

The intention is to be positioned around median market practice and the Group participates in reward surveys to benchmark its reward practices.

Further disclosure in respect of Directors emoluments are set out in the Regulated Accounts of the Company which are available on the Company website.

On behalf of the Board

Gordon Maxwell
Chairman
4 July 2014

Directors' Report

The directors have pleasure in submitting their report and the audited financial statements for the year ended 31 March 2014.

Principal activities

The principal activities of the Group comprise the supply of water to a population of 2.1 million in an area of 5,657 square kilometres and the provision of certain ancillary services for customers, developers and other bodies within the constraints of the regulating statutes. The directors consider the performance of the business to be satisfactory and that this is expected to continue in the future.

Appointment as a Water Undertaker and the Ring-fence
South East Water Limited has been appointed as a water undertaker under the Water Industry Act 1991 and the duties and the obligations of the appointee are set out in that Act, in regulations created under that Act, and in its instrument of appointment. The conditions of the instrument of appointment cover a variety of areas including charges, accounts and information and various codes of practice.

Condition K of the Licence deals with ring-fencing and requires the Company to ensure, so far as is reasonably practicable, that it retains at all time sufficient rights and assets (other than financial resources) for a special administrator, if appointed, to be able to manage the affairs of the business. The Company must confirm this annually. Condition F requires the Company to ensure that it has sufficient financial and managerial resources and adequate systems of planning and internal control to carry out the regulated activities and again requires the Company to certify this annually. Furthermore, Condition F requires that the Company should at all times conduct the appointed business as if it was substantially the Company's sole business and the Company was a separate public limited company. The licence sets out a number of factors to which the Company should have particular regard when meeting this particular Condition. The ultimate controller of the appointee is bound by a binding undertaking with Ofwat required under condition P of the Licence to procure that its subsidiary other than the appointee provide information required by the appointee to comply with its obligations under the Water Industry Act 1991 and the Licence and to refrain from any action that would cause the appointee to breach any of these obligations.

The effect of the relevant legislation and the terms of the Licence mean that, whilst South East Water is not a public listed company, its directors have an overriding responsibility to ensure the regulatory ring-fence is maintained. The directors remain mindful of these obligations along with their duties as directors set out in the Companies Act 2006. One of the ways the directors meet the ring-fencing obligations is by ensuring that all Board level matters that affect the Company are decided at the Board of South East Water Ltd, rather than at a holding company level.

Group Structure

South East Water Limited is the main operating company in the group of companies headed by HDF (UK) Holdings Limited. The ultimate owners of HDF (UK) Holdings Limited are Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia, and Caisse de dépôt et placement du Québec and Desjardin Employees Pension Fund. There are two intermediate holding companies between the Company and HDF (UK) Holdings Limited: South East Water (Holdings) Limited and Hastings Water (UK) Limited, both of which companies, together with HDF (UK) Holdings Limited, are registered and resident in the UK.

The debt financing of South East Water is arranged by South East Water itself and by its only subsidiary, South East Water (Finance) Limited. South East Water (Finance) Limited is a company registered in the Cayman Islands but is resident for tax purposes in the UK. There is further debt finance in the group which is a mixture of both external and shareholder loans and this debt is issued by a separate group company, Hastings Luxembourg Water S.a.r.l.

Accounting framework

The financial information presented in the audited Group financial statements on pages 37 to 77 has been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union. The financial information concerning the Company as a single entity on pages 78 to 106 has been prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP).

Directors' Report

The results for the prior year have been restated because of the adoption of IAS 19(R) Employee Benefits and a change in accounting policy introducing the capitalisation of interest on qualifying expenditure on fixed assets as permitted by FRS 15 Tangible Fixed Assets. Both of these changes are discussed further in note 2 of the financial statements.

Business review and future developments

Turnover for the Group for the year ended 31 March 2014 was £213.6 million (2013: £207.9 million) and operating profit was £96.2 million for the year (2013 (restated): £100.4 million). Profit before taxation for the year was £51.4 million (2013 (restated): £41.6 million). The financial position at 31 March 2014 for the Group and for the Company is shown on pages 38 and 79 respectively. Further analysis of the performance of the business and future developments is included in the Strategic Report on page 5.

Dividends

The directors have approved dividends totalling £30 million (2013: £31 million) for the year paid in equal instalments of £7.5 million per quarter. Further details are given in notes 10 and 39. The Company's immediate parent company, South East Water (Holdings) Ltd used £4.8 million of this dividend (2013: £5.3 million) to pay interest on an inter-company loan back to South East Water Limited.

Capital expenditure

During the year the Group's capital expenditure totalled £99.6 million (2013 (restated): £96.2 million). Further details are given in notes 12 and 13. The Company's financial position is detailed in note 40.

In the opinion of the directors, the market value of land is significantly more than its book value, however it would not be practicable to precisely quantify this.

Taxation

Whilst the Group makes profits, the extensive investment programme currently being undertaken by the Company typically means that any taxable profits are exceeded by available capital allowances. As tax losses are available elsewhere in the HDF (UK) Holdings Ltd group in practice we defer taking some capital allowances and purchase group relief to settle the resulting tax charge.

Directors and their interests

The directors who served at the date of this report are set out on page 3. During the year David Hinton was appointed to the Board as Asset & Regulation Director and Paul Rich, Jean Pierre Ouellet, Peter Dixon and Patrick Côté were appointed to the Board as non-executive directors. David Shore, Jean-Etienne Leroux, Kanishk Bhatia and Robert Weeden resigned from the Board.

No director held any shares or loan stock in the Company or other associated companies required to be disclosed under the Companies Act 2006 during the financial year.

Directors' liabilities

The Group has granted an indemnity to its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

Principal risks and uncertainties

A description of the Group's principal risks and uncertainties and an explanation of the steps the Board takes to mitigate these risks are provided in the Strategic Report.

Directors' Report

Environmental and corporate social responsibility

The Group's approach to sustainable development of its business includes a strong commitment to the environment and corporate social responsibility. Further details are given in the Strategic Report.

Employment policies

The Group offers equal opportunities to all staff and applicants for employment. Its managers and officers are trained to ensure there is no unlawful discrimination on grounds of race, gender, age, religion, union membership, disability or sexual orientation. Employment policies are intended to confirm the Group as an employer of choice through provision of a safe work environment, satisfying work, personal development and fair rewards. Further details are given in the Strategic Report.

The Group gives full consideration to applications for employment from disabled persons where the candidate's particular aptitudes and abilities are consistent with meeting the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Where existing employees become disabled it is the Group's policy to provide continuing employment, wherever practicable, in the same position or in an alternative position and to provide appropriate training to achieve this aim.

Employee consultation

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on various factors affecting the performance of the Group. This is achieved through formal and informal meetings, regular bulletins on the Group's intranet and the Group's employee magazine. Employee representatives are consulted regularly through the Staff Council on a wide range of matters affecting their current and future interest.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described on pages 37 to 77. This Report includes a description of the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. Its facilities were undrawn during the year and at the date of signing these accounts. The Group's annual budget and forecasts, together with its five year plan and longer resources planning, all indicate that the Group should be able to continue operating, utilising its current financial resources and the proceeds of future borrowing opportunities which are expected to become available.

The directors believe that the Company and Group are well placed to manage its business risks successfully despite the current uncertain economic outlook and the ongoing regulatory review. After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Auditor

The directors who were members of the Board at the time of approving the directors' report are listed on page 3. Having made enquiries of fellow directors, each of these directors confirms that:

- so far as the director is aware, there is no relevant audit information of which the Group's auditor is unaware; and
- each director has taken all the steps a director ought to have taken to be aware of relevant audit information and to establish that the Group's auditor is aware of that information.

Directors' Report

This confirmation is given and should be interpreted in accordance with provisions of s418 of the Companies Act 2006.

In the absence of a general meeting, Deloitte have been re-appointed as auditor in accordance with the terms of their contract.

Donations

No political donations were made by the Group in either period.

By order of the Board

N Truillet
Company Secretary
4 July 2014

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the group financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole;
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

P Butler
Managing Director
4 July 2014

J E Stimpson
Finance Director
4 July 2014

Independent auditor's report to the members of South East Water Limited

We have audited the Group and Company only financial statements of South East Water Limited for the year ended 31 March 2014 which comprise the Group income statement, the Group statement of comprehensive income, the Group statement of financial position, the Group statement of changes in equity, the Group statement of cash flows and the related Group notes 1 to 30, the Parent Company income statement, the Parent Company statement of total recognised gains and losses, the Parent Company balance sheet, the Parent Company cash flow statement and the related Parent Company notes 31 to 57. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2014 and of the group's and the parent company's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditor's report to the members of South East Water Limited

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Jacqueline Holden FCA (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
4 July 2014

Group income statement
for the year ended 31 March 2014

	Notes	2014 £000	2013 (restated) £000
Revenue	3	**213,588**	207,887
Operating costs before exceptional item		**(122,917)**	(116,807)
Exceptional item: pension curtailment gain	5/24	**-**	4,245
Group net operating costs	5	**(122,917)**	(112,562)
Other income	3	**5,494**	5,089
Group operating profit		**96,165**	100,414
Finance costs	7	**(50,033)**	(64,633)
Finance income	8	**5,295**	5,789
Profit before taxation		**51,427**	41,570
Taxation	9	**8,209**	(2,550)
Profit for the year		**59,636**	39,020
Earnings per share			
Basic and diluted from continuing operations	11	**120.94**	79.13p

Profit for the year is generated entirely from continuing operations.

Group statement of comprehensive income
for the year ended 31 March 2014

	Notes	2014 £000	2013 (restated) £000
Profit for the year		**59,636**	39,020
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of defined benefit liability	24	**2,376**	(7,536)
Income tax relating to items not reclassified	9	**(546)**	1,753
Impact of deferred tax rate change in respect of the pension schemes	9	**(1,681)**	(584)
		149	(6,367)
Total comprehensive income for the year attributable to Owners of the Company		**59,785**	32,653

Group statement of financial position
as at 31 March 2014

	Notes	2014 £000	2013 £000
Non-current assets			
Intangible assets	12	**9,713**	7,816
Property, plant and equipment	13	**1,206,508**	1,143,773
Investments	15	**190,013**	190,013
		1,406,234	1,341,602
Current assets			
Inventories	16	**267**	136
Trade and other receivables	17	**63,713**	58,768
Cash and cash equivalents	18	**52,710**	99,494
		116,690	158,398
Total assets		**1,522,924**	1,500,000
Current liabilities			
Financial liabilities - Loans and borrowings	19	**(1,237)**	(4,149)
Trade and other payables	21	**(87,950)**	(93,161)
Deferred income	25	**(3,444)**	(3,408)
Provisions	20	**(3,233)**	(1,728)
		(94,464)	(102,446)
Non-current liabilities			
Loans and borrowings	19	**(853,338)**	(840,442)
Trade and other payables	19	**(1,012)**	(955)
Derivative financial instruments	19/23	**(82,971)**	(81,917)
Deferred tax liabilities	9	**(120,619)**	(130,020)
Defined benefit pension liability	24	**(33,230)**	(41,363)
Deferred income	25	**(58,282)**	(55,034)
		(1,149,452)	(1,149,731)
Total liabilities		**(1,245,316)**	(1,252,177)
Net assets		**277,608**	247,823
Equity			
Ordinary share capital	26	**49,312**	49,312
Capital redemption reserve		**4,000**	4,000
Retained earnings		**224,296**	194,511
Total equity		**277,608**	247,823

Group statement of financial position
as at 31 March 2014

The accompanying notes are an integral part of this balance sheet.

The consolidated financial statements on pages 37 to 77 were approved by the Board of Directors on 5 July 2014 and were signed on its behalf by:

P Butler
Managing Director
4 July 2014

J E Stimpson
Finance Director
4 July 2014

Group statement of changes in equity

for the year ended 31 March 2014

	Issued share capital £000	Capital redemption reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2012	49,312	4,000	192,858	246,170
Profit for the year (restated)	-	-	39,020	39,020
Other comprehensive loss (restated)	-	-	(6,367)	(6,367)
Total comprehensive income	-	-	32,653	32,653
Dividends (see note 10)	-	-	(31,000)	(31,000)
Balance at 31 March 2013	49,312	4,000	194,511	247,823
Profit for the year	-	-	59,636	59,636
Other comprehensive income	-	-	149	149
Total comprehensive income	-	-	59,785	59,785
Dividends (see note 10)	-	-	(30,000)	(30,000)
Balance at 31 March 2014	**49,312**	**4,000**	**224,296**	**277,608**

All transactions relate to the equity holders of the Company.

Non-distributable reserves

The retained earnings of the Group includes a non-distributable reserve of £22.7 million (2013: £22.7 million) arising from the transfer of the trade and certain assets and liabilities of Mid Kent Water Limited to the Group.

The capital redemption reserve relates to the redemption of 4,000,000 8.75% redeemable preference shares on 31 March 1996.

Group statement of cash flows
for the year ended 31 March 2014

	Notes	**2014 £000**	2013 £000
Operating activities			
Net cash generated from operations	27	**124,554**	120,566
Interest received		**5,360**	9,369
Interest paid		**(42,681)**	(26,497)
Group tax relief paid		**(4,002)**	(5,165)
Net cash flow from operating activities		**83,231**	98,273
Investing activities			
Proceeds from sale of property, plant and equipment		**205**	779
Purchase of property, plant and equipment		**(97,228)**	(88,562)
Purchase of intangible assets		**(2,832)**	(2,434)
Fixed asset contributions received		**3,989**	734
Net cash flow used in investing activities		**(95,866)**	(89,483)
Financing activities			
Finance lease principal payments		**(1,149)**	(1,066)
Repayments of borrowings		**(3,000)**	(3,000)
Proceeds from new loan issue		**-**	100,000
Issue costs on new loan paid		**-**	(1,896)
Dividends paid to shareholder	10	**(30,000)**	(31,000)
Net cash flow (used in)/received from financing activities		**(34,149)**	63,038
(Decrease)/increase in cash and cash equivalents		**(46,784)**	71,828
Cash and cash equivalents at the beginning of the year		**99,494**	27,666
Cash and cash equivalents at the year end	18	**52,710**	99,494

Notes to the Group financial statements

for the year ended 31 March 2014

1. Authorisation of financial statements and statement of compliance with IFRSs

The financial statements of South East Water Limited and its subsidiary (the "Group") for the year ended 31 March 2014 were authorised for issue by the Board of Directors on 5 July 2014 and the Statement of Financial Position was signed on the Board's behalf by Paul Butler and Jo Stimpson. South East Water Limited is a limited liability company incorporated in the United Kingdom and domiciled in England and Wales.

The principal accounting policies adopted by the Group are set out in note 2.

2. Accounting policies

Basis of preparation

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and applied in accordance with the Companies Act 2006.

The Group financial statements are prepared under the historical cost convention except for pension assets and liabilities and certain financial instruments that have been measured at fair value and property, plant and equipment which was recognised at the date of transition to IFRS at deemed cost by reference to fair value.

The Group financial statements are presented in sterling and all values are rounded to the nearest thousand pounds (£000) except where otherwise indicated.

Changes in accounting policies

During the year the Group has adopted IAS 19 (as revised in June 2011) Employee Benefits ("IAS 19(R)"). The Group has applied IAS 19(R) retrospectively. The transitional provisions do not have an impact on future periods. The amendments in IAS 19(R) change the accounting for defined benefit schemes and termination benefits. The effects of these amendments are to accelerate the recognition of past service costs, to require the recognition of changes in defined benefit obligations and in fair value of scheme assets when they occur, to introduce a net interest amount in the income statement which is calculated by applying a discount rate to the net defined benefit asset or liability and for the net pension asset or liability recognised in the consolidated balance sheet to reflect the full value of the scheme deficit or asset.

As the Group has always recognised actuarial gains and losses immediately, there is no effect on the prior year defined benefit obligation and balance sheet disclosure. The effects on the consolidated income statement and the statement of comprehensive income are as follows:

	2014 £000	2013 £000
Impact on consolidated income statement		
Increase in operating costs	(1,121)	(1,121)
Decrease in finance costs	196	951
	(925)	(170)
Increase/decrease in tax credit/charge	185	56
Net impact on consolidated income statement	(740)	(114)
Impact on statement of comprehensive income		
Decrease in profit for the year	(740)	(114)
Increase in actuarial gain	925	170
Increase in income tax charge	(185)	(56)
Net impact on statement of comprehensive income	-	-

Notes to the Group financial statements

for the year ended 31 March 2014

2. Accounting policies *(continued)*

Basis of consolidation

The Group financial statements incorporate the financial information of South East Water Limited (the "Company") and its subsidiary South East Water (Finance) Limited.

Transactions and balances between the Company and its subsidiary have been eliminated fully on consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described on pages 37 to 77. The Strategic Report on page 5 includes a description of the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. Its facilities were undrawn during the year and at the date of signing these accounts. The Group's annual budget and forecasts together with its five year plan and longer resources planning all indicate that the Group should be able to continue operating utilising its current financial resources and the proceeds of future borrowing opportunities expected to become available.

The directors believe that the Company and Group are well placed to manage its business risks successfully. After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Judgements and key sources of estimation uncertainty

The preparation of financial statements requires the application of judgements, estimates and assumptions by management, which affects assets and liabilities at the balance sheet date and income and expenditure for the year. Actual results may differ from those estimates.

The most critical judgements, estimates and assumptions are set out below:

- the remaining useful lives of infrastructure assets: the Group's infrastructure assets are a network for the supply of potable water to customers. There is no definite life of these assets, so management makes an assumption based on previous experience of the usage of the network. For the purposes of calculating depreciation on these assets a remaining life of an average of 94 years has been assumed;
- un-invoiced water income at the year-end: domestic metered and smaller commercial customers are billed on a six monthly cycle which means at the year end a large volume of water has been supplied that has not been invoiced. Management estimates the value of the water supplied based on previous consumption. The value of unbilled water income at 31 March 2014 was £27.8 million (2013: £24.4 million). The increase in un-invoiced water during the year is predominantly a result of more customers moving to measured supplies;
- the capitalisation of employee and other directly attributable costs: the Group determines employee costs directly attributable to capital projects based on time spent. Other directly attributable costs are then assessed and costs relating to capital projects are capitalised into individual projects. During the year £10.7 million of employee and other directly attributable costs have been capitalised (2013: £10.0 million);
- the provision for doubtful trade receivables: an estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions. The value of the provision for doubtful debts as at 31 March 2014 was £29.6 million (2013: £27.6 million);

Notes to the Group financial statements

for the year ended 31 March 2014

2. Accounting policies *(continued)*

- the fair value of the interest rate swap: this valuation requires the Group to make estimates about expected inflation and future interest rates, hence the valuation is subject to uncertainties. The fair value at 31 March 2014 is £83.0 million (2013: £81.9 million); and
- pension and other post-employment benefits: the cost of defined benefit pensions schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets, and corporate bond performance projections as set out in note 24. Pension increases are based on expected future inflation rates. The employee liability at 31 March 2014 is £33.2 million (2013: £41.3 million).

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group, there has been a transfer of risk and control and the revenue can be reliably measured. All revenue arises within the United Kingdom and is recorded net of VAT. Specific recognition criteria must also be met before revenue is recognised as detailed below.

Metered and unmetered water income
Revenue is recognised when water has been delivered to the customer. Revenue includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

Infrastructure charges
Infrastructure charges represent the fees charged to property developers and others for connecting new properties and water outlets to the Group's network. Such fees are recognised in the income statement when they are received.

Other income
Other income includes rechargeable works charges and charges for engineering, scientific, laboratory, billing and cash collection services. Rechargeable works represent payments received from developers for installing meters and connections to new property developments. Other income is recognised when the work is complete.

Finance income
Finance income is recognised using the effective interest method.

Exceptional items

Exceptional items are material items of income and expense disclosed separately to enable a full understanding of the Group's financial performance.

Taxation

Current tax, being UK Corporation Tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Deferred tax is provided using the liability method on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Notes to the Group financial statements
for the year ended 31 March 2014

2. Accounting policies *(continued)*

Deferred tax liabilities are recognised for all taxable temporary differences except where the deferred tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences and the carry forward of unused tax assets and losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences and the carry forward of unused tax assets and losses can be utilised.

Deferred tax assets are recognised for the deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date. In accordance with IAS 12 *Income Taxes,* deferred taxes are not discounted.

Dividends

Dividends are recorded in the accounts in the year in which they are approved by the Board.

Intangible assets

Software
Software intangible assets externally acquired are recognised at cost. They have finite useful lives and are amortised over three to five years on a straight-line basis. Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Employee and other costs directly attributable to intangible asset projects are capitalised in the financial statements as part of the cost of the intangible asset to which they relate. Training costs, administration and other general overhead costs including interest are not capitalised.

Derecognition
An intangible asset is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the item, is included in the income statement in the year in which the item is derecognised.

Property, plant and equipment

Infrastructure assets
Infrastructure assets comprise a network of systems relating to water distribution. Infrastructure assets in the course of construction are depreciated from the time they are brought into use and are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the assets, being between 20 years for short-life assets and 100 years for all other infrastructure assets.

Non - infrastructure assets
Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. All other non-infrastructure assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

Notes to the Group financial statements
for the year ended 31 March 2014

2. Accounting policies *(continued)*

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and office equipment	3-10

Derecognition
An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Residual values and useful lives
Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Capitalisation of employee and other directly attributable costs
Employee and other costs, including borrowing costs, directly attributable to capital projects are capitalised in the financial statements as part of the cost of the property, plant and equipment to which they relate. Training costs, administration and other general overhead costs are not capitalised.

Leased Assets
Property, plant and equipment held under finance leases are capitalised at the lower of the fair value of the leased asset and the present value of the minimum lease payments. These assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Impairment of property, plant and equipment, investments and intangible assets

At each reporting date an assessment is carried out to determine whether there is any indication that property, plant and equipment, investments and software intangible assets may be impaired. If there is an indication of impairment, the recoverable amount of the asset or respective cash-generating unit is compared to the carrying amount. Where the recoverable amount is less than the carrying amount, the asset value is reduced to the recoverable amount with an impairment loss recognised as an operating cost in the income statement in the year in which the respective assessment takes place.

Borrowing costs

Borrowing costs are incurred on the Group's general borrowings. Where appropriate borrowing costs are attributed to qualifying assets in line with IAS 23 Borrowing Costs. Otherwise borrowing costs are expensed as incurred. See note 7 for further details.

Grants and Contributions

Grants and contributions are received in respect of both infrastructure and non-infrastructure assets. These are recognised as deferred income and are released to the income statement over the life of the assets to which they relate.

Inventory

Inventory is valued at the lower of average cost or net realisable value. The stocks of treated water held by the Group are valued at nil. Consumable chemical purchases are recognised as an expense in the income statement at the point of purchase.

Work-in-progress for chargeable services is valued at the lower of cost and net realisable value.

Notes to the Group financial statements
for the year ended 31 March 2014

2. Accounting policies *(continued)*

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

Included within cash and cash equivalents are amounts that are held in designated bank accounts as short term deposits in order to meet the interest and associated swap payments falling due in respect of listed debt and other long-term borrowings.

Trade payables

Trade payables are measured at fair value and subsequently measured at amortised cost.

Financial instruments

The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, a loan to its parent undertaking, cash, short-term and medium-term bank deposits, trade receivables and trade and other payables.

Recognition
Financial instruments are recognised on the balance sheet when the Group becomes party to the contractual provisions of the instrument. The Group determines the classification of its financial liabilities at initial recognition.

Derecognition
Financial liabilities are removed from the balance sheet when the related obligation is discharged, cancelled or expires.

Financial assets are removed from the balance sheet when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

Embedded derivatives
Financial instruments that are not carried at fair value through the income statement are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

Derivative financial instruments
The Group uses an interest rate swap to hedge its risks associated with certain interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the balance sheet at fair value with any movements during the year charged or credited to the income statement. The fair value is determined by reference to market values for similar instruments.

Interest bearing loans and borrowings
All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Short-term trade and other receivables
Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

Notes to the Group financial statements
for the year ended 31 March 2014

2. Accounting policies *(continued)*

Impairment of financial assets
At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced through the use of an allowance account in accordance with IAS 39 Financial Instruments: Recognition and measurement, with the loss being recognised in the income statement in the year in which the respective assessment takes place. Impaired debts are derecognised when they are assessed as irrecoverable.

Leases

Finance leases, which substantially transfer to the Group all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease with a corresponding liability being recognised, at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance charges related to assets prior to April 2009 were charged directly to the income statement whereas finance charges post April 2009 are capitalised as part of fixed assets as long as they are directly attributable to a qualifying asset. Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases and rentals payable are recognised as an expense in the income statement on a straight-line basis over the lease term.

Provisions

A provision is recognised when the Group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects the risks specific to the liability.

Research and development

Research costs are charged to the income statement in the year in which they are incurred.

Development costs are capitalised based on management's judgement that the technological and economic feasibility of a project is confirmed, usually when a project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

Pension and other post-employment benefits

The Group accounts for pensions and other post-employment benefits under IAS 19(R). The Group operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans.

Defined contribution plans
Contributions to defined contribution plans are recognised as an expense in the income statement when the contributions fall due.

Defined benefit plans
The pension scheme liability in the balance sheet represents the net present value of the defined benefit obligation and the fair value of scheme assets at the balance sheet date. The present value of the defined benefit obligation is analysed between the funded and unfunded pension plans.

Notes to the Group financial statements

for the year ended 31 March 2014

2. Accounting policies *(continued)*

The present value of the defined benefit obligation and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

The pension cost in the income statement includes current and past service cost and the effect of any settlements and curtailments. A net finance charge or credit is recognised within finance costs in the income statement and comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities.

All actuarial gains and losses and the related current and deferred taxation are recognised in the statement of recognised income and expense.

New standards and interpretations adopted

The Group has adopted the following new and amended IAS, IFRS and IFRC interpretations as of 1 April 2013:

International Standards (IAS/IFRSs)		Effective date
IFRS 7 (amended)	Offsetting Assets and Liabilities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 1 (amended)	Comprehensive Income	1 July 2012
IAS 12 (amended)	Deferred Tax: Recovery of Underlying Assets	1 January 2013
IAS 19 (amended)	Employee Benefits	1 January 2013

Details of the impact of the adoption of IAS 19 (amended) are given on page 42. The adoption of the remaining above standards and interpretations has had no significant impact on the financial statements of the Group or company.

New standards and interpretations not applied

As the Group prepare their financial statements in accordance with IFRS as adopted by the European Union, the application of new standards and interpretations will be subject to their having been endorsed for use in the EU via the EU Endorsement mechanism. In the majority of cases this will result in an effective date consistent with that given in the original standard or interpretation but the need for endorsement restricts the Group's discretion to early adoption of the standards.

At the date of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

IFRS 9 (amended)	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interest in Other Entities
IAS 27 (amended)	Separate Financial Statements (May 2011)
IAS 28 (amended)	Investments in Associates and Joint Ventures (May 2011)
IAS 32 (amended)	Offsetting Financial Assets and Financial Liabilities
IAS 36 (amended)	Disclosure of Non-Financial Assets
IAS 39	Hedge Accounting

The adoption of IFRS 9, which the Group plans to adopt for the year beginning on 1 April 2015, will impact both the measurement and disclosure of Financial Instruments. The directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the Group in future periods.

Notes to the Group financial statements
for the year ended 31 March 2014

3. Total income

	2014 £000	2013 £000
Revenue		
Unmetered water income	**81,636**	95,340
Metered water income	**127,827**	108,681
Other sales	**4,125**	3,866
	213,588	207,887
Other income		
Rental income	**1,203**	1,222
Sundry income	**4,291**	3,867
	5,494	5,089
Total revenue	**219,082**	212,976

All revenue is from customers within the United Kingdom.

Sundry income includes charges for billing and cash collection services amounting to £2.3 million (2013: £2.1 million), and laboratory income of £1.0 million (2013: £0.7 million).

4. Segmental analysis

The Group's revenue mainly arises from the supply of water and related activities. The activities of the Group, for management purposes, fall into three operating areas being regulated activities, non-regulated activities and new connections to the Group's network. However, because of the relative size of the latter two segments they are reported together as "Other activities" below.

The Group analyses results by segment to operating profits only, so no segmental statement of financial position or statement of cash flows are presented.

The adjustment of revenue relates to work performed on the Group's network for new connections on behalf of third parties. This is reported as revenue for management purposes, but is treated as capital contributions for the purposes of these accounts.

Year ended 31 March 2014	Regulated activities £000	Other activities £000	Adjustments £000	Total £000
Total revenue	212,752	5,236	(4,400)	213,588
Operating profit	90,741	5,424	-	96,165
Investment income				5,295
Finance costs				(50,033)
Profit before taxation				51,427
Taxation				8,209
Profit for the year				**59,636**

Notes to the Group financial statements

for the year ended 31 March 2014

4. Segmental analysis *(continued)*

Year ended 31 March 2013	Regulated activities £000	Other activities £000	Adjustments £000	Total £000
Total revenue	206,570	4,553	(3,236)	207,887
Operating profit (restated)	95,496	4,918	-	100,414
Investment income				5,789
Finance costs (restated)				(64,633)
Profit before taxation				41,570
Taxation (restated)				(2,550)
Profit for the year				39,020

5. Group net operating costs

	Notes	**2014 £000**	2013 (restated) £000
Employee benefits expense excluding exceptional item	6	**23,906**	23,299
Exceptional item: pension curtailment gain (see below)	24	**-**	(4,245)
Asset expense/(income):			
Depreciation – owned assets		**31,522**	29,317
Depreciation – leased assets		**565**	1,426
Amortisation of intangible assets		**2,683**	2,189
(Profit)/loss on disposal of non-current assets		**(25)**	151
		34,745	33,083
Other operating expenses:			
Operating lease rentals:			
vehicles and office equipment		**105**	127
land and buildings		**420**	403
Fees payable to the Group's auditor (see below)		**256**	219
Other expenses (see page 52)		**38,236**	64,344
Other operating expenses charged to capital projects		**(4,751)**	(4,668)
		64,266	60,425
		122,917	112,562

Curtailment gains of £4.2 million in the prior year arose from changes to the Group's defined benefit pension schemes and have been classified as an exceptional item. The gains arose as a result of changes to the schemes' benefits, which have reduced future liabilities. The directors consider that, due to the materiality and the one-off nature of these curtailment gains, it is appropriate to classify them as exceptional items in order to show a true and fair view of the Group's underlying performance. The tax charge on the exceptional items was £1.0 million. The exceptional items had £nil impact on the Group's cash flows.

Notes to the Group financial statements
for the year ended 31 March 2014

5. Group net operating costs *(continued)*

	2014 £000	2013 £000
Fees payable to the Group's auditor in respect of:		
Audit of the Group and Company financial statements	**112**	108
Audit of subsidiary	**2**	2
Total audit	**114**	110
Regulatory accounts	**24**	24
Other assurance services	**37**	26
	61	50
Services relating to taxation	**43**	50
Other non-audit services	**38**	9
Total other non-audit services	**81**	59
Total non-audit services	**142**	109
Total fees charged to income statement	**256**	219
Other expenses comprise:		
Energy costs	**15,014**	12,751
Rates	**14,147**	13,728
Contractors	**10,758**	10,058
Bulk water supplies and abstraction licences	**9,189**	9,230
Bad debts	**3,771**	2,718
Chemicals	**2,633**	2,365
Insurance	**2,657**	2,729
Other	**10,149**	10,800
	68,318	64,379

6. Directors and employees

The average monthly number of persons, including salaried directors, employed by the Group in the year was:

	2014 Number	2013 Number
Operations	**490**	489
Management and administration	**299**	260
	789	749

Notes to the Group financial statements
for the year ended 31 March 2014

6. Directors and employees *(continued)*

	Notes	**2014**	2013 (restated)
		£000	£000
The aggregate payroll costs of these persons were:			
Wages and salaries		**23,997**	22,764
Social security costs		**2,430**	2,289
Pension costs for defined benefit schemes	24	**2,889**	3,220
Pension costs for defined contribution schemes	24	**517**	237
		29,833	28,510
Less: direct salary costs charged to capital projects		**(5,927)**	(5,211)
		23,906	23,299
Exceptional item: pension curtailment gain (see note 5)		**-**	(4,245)

Emoluments of the directors, who are the Group's key management, were:

	2014	2013
	£000	£000
Aggregate emoluments including bonuses	**1,220**	1,262
Company contributions to defined contribution scheme	**25**	9
	1,245	1,271
Emoluments of the highest paid director were:		
Aggregate emoluments including bonuses	**317**	277

Retirement benefits are accruing to five directors (2013: four) under the defined benefit pension schemes and one director (2013: one) under a defined contribution scheme. Further disclosures in respect of Directors' emoluments are set out in the Regulated Accounts of the company which are available on the Company's website.

7. Finance costs

	Notes	**2014**	2013 (restated)
		£000	£000
Debenture interest		**119**	427
Effective interest on listed debt		**23,818**	22,125
Fair value movements on interest rate swap		**1,053**	17,697
Indexation on variable rate bonds		**6,346**	6,274
Bank interest and other finance charges		**1,118**	563
Financing guarantee fees		**1,538**	1,457
Interest payable on finance leases		**211**	289
Interest payable on index linked loans		**8,332**	8,074
Indexation on index linked loans		**7,239**	7,049
Amortisation of loan issue costs		**548**	509
Pension fund finance charge	24	**1,508**	1,833
Interest payable		**51,830**	66,297
Interest capitalised		**(1,797)**	(1,664)
		50,033	64,633

Notes to the Group financial statements
for the year ended 31 March 2014

7. Finance costs *(continued)*

Interest capitalised during the year amounted to £1.8 million (2013: £1.7 million) and is calculated using the weighted average interest rate of the Group's long-term lending of 4.28% (2013: 4.03%).

8. Finance income

	2014	2013
	£000	£000
Interest receivable on bank balances and short-term deposits	**518**	504
Interest receivable from group undertakings	**4,777**	5,285
	5,295	5,789

9. Taxation

Major components of the tax expense for the years ended 31 March 2014 and 2013 are:

	2014	2013 (restated)
	£000	£000
Group income statement		
Current tax:		
Current UK tax charge	**3,419**	3,938
Amounts over provided in previous years	**-**	(252)
	3,419	3,686
Deferred tax:		
Relating to origination and reversal of temporary differences	**8,285**	5,093
Impact of deferred tax rate change	**(19,913)**	(6,229)
	(11,628)	(1,136)
Tax (credit)/charge reported in the group income statement	**(8,209)**	2,550
Tax charge/(credit) to equity		
Deferred tax on defined benefit pension schemes	**546**	(1,753)
Impact of deferred tax rate change in respect of the pension schemes	**1,681**	584
Tax reported in equity	**2,227**	(1,169)

Notes to the Group financial statements

for the year ended 31 March 2014

9. Taxation *(continued)*

Factors affecting the tax charge for the year

The tax for the year is lower than the standard rate of corporation tax in the UK. The differences are explained below:

	2014	2013 (restated)
	£000	£000
Profit before tax	**51,427**	41,570
Profit multiplied by the rate of corporation tax in the UK of 23% (2013: 24%)	**11,828**	9,977
Effects of:		
Adjustments to current tax charge in respect of previous periods	**-**	(252)
Adjustments to deferred tax charge in respect of previous periods	**(299)**	(424)
Expenses not deductible for tax purposes	**175**	241
Rolled over gains	**-**	(763)
Impact of rate change on deferred tax	**(19,913)**	(6,229)
Total tax (credit)/charge reported in the group income statement	**(8,209)**	2,550

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 20% (2013: 23%).

Deferred tax

The movement on the net deferred tax liability is as shown below:

	2014	2013 (restated)
	£000	£000
At 1 April	**130,020**	132,325
Credit to the income statement	**(11,628)**	(1,136)
Charge/(credit) to equity	**2,227**	(1,169)
At 31 March	**120,619**	130,020

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered by giving relief against future taxable profits.

The movements in deferred tax assets and liabilities during the year are shown below:

	Accelerated tax depreciation £000	Rolled over gains £000	Total £000
Deferred tax liabilities			
At 1 April 2012	157,048	796	157,844
Credit to the income statement	(704)	(796)	(1,500)
At 1 April 2013	**156,344**	**-**	**156,344**
Credit to the income statement	**(15,198)**	-	**(15,198)**
At 31 March 2014	**141,146**	**-**	**141,146**

Notes to the Group financial statements
for the year ended 31 March 2014

9. Taxation *(continued)*

	Fair value Swap £000	Deferred income £000	Pension provision £000	Other provision £000	Total £000
Deferred tax assets					
At 1 April 2012	2,293	12,637	10,451	138	25,519
Credit/(charge) to the income statement	1,607	110	(2,107)	26	(364)
Credit to equity	-	-	1,169	-	1,169
At 1 April 2013	**3,900**	**12,747**	**9,513**	**164**	**26,324**
(Charge)/credit to the income statement	**(1,787)**	**(1,128)**	**(640)**	**(15)**	**(3,570)**
Charge to equity	**-**	**-**	**(2,227)**	**-**	**(2,227)**
At 31 March 2014	**2,113**	**11,619**	**6,646**	**149**	**20,527**

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax liability at 31 March 2014 was £120.6 million (2013: £130.0 million).

Capital investment is expected to remain at similar levels and the Group expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Limited group of companies.

The Budget announced by the UK Chancellor on 20 March 2013 included changes to the main rate of corporation tax for UK companies.

The standard rate of corporation tax will be reduced from 23% to 21% from 1 April 2014 and there will be a further reduction to 20% with effect from 1 April 2015. The Finance Act 2013 received Royal Assent on 17 July 2013, with these rate reductions being substantively enacted from 2 July 2013. The deferred tax assets and liabilities at the balance sheet date are calculated at the substantively enacted rate of 20%.

10. Dividends

	2014 £000	2013 £000
Equity dividends paid during the year:		
First interim dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share)	**7,500**	7,750
Second interim dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share)	**7,500**	7,750
Third interim dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share)	**7,500**	7,750
Final dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share)	**7,500**	7,750
	30,000	31,000

There were no dividends proposed for approval as at 31 March 2014 and 31 March 2013.

Notes to the Group financial statements
for the year ended 31 March 2014

11. Earnings per ordinary share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year. The following reflects the income and shares data used in the basic and diluted earnings per share computations:

	2014	2013 (restated)
	£000	£000
Profit for the year	**59,636**	39,020
	Number	Number
Basic and diluted weighted average number of shares	**49,312,354**	49,312,354
Basic and diluted earnings per share	**120.94p**	79.13p

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

12. Intangible assets

	Computer software £000
Cost	
At 1 April 2013	23,304
Additions	4,580
Disposals	(1,197)
At 31 March 2014	**26,687**
Amortisation	
At 1 April 2013	(15,488)
Charge for the year	(2,683)
Eliminated on disposals	1,197
At 31 March 2014	**(16,974)**
Net book amount at 31 March 2014	**9,713**
Cost	
At 1 April 2012	19,696
Additions	3,731
Disposals	(123)
At 31 March 2013	23,304
Amortisation	
At 1 April 2012	(13,422)
Charge for the year	(2,189)
Eliminated on disposals	123
At 31 March 2013	(15,488)
Net book amount at 31 March 2013	7,816

Notes to the Group financial statements
for the year ended 31 March 2014

13. Property, plant and equipment

	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Assets in the course of construction £000	Total £000
Cost					
At 1 April 2013	217,019	751,331	295,952	97,411	1,361,713
Reclassifications	(938)	1,092	(154)	-	-
Additions	-	-	-	95,002	95,002
Transfers	6,138	69,029	34,675	(109,842)	-
Disposals	(334)	(1,637)	(3,868)	-	(5,839)
At 31 March 2014	221,885	819,815	326,605	82,571	1,450,876
Accumulated depreciation					
At 1 April 2013	(33,203)	(54,098)	(130,639)	-	(217,940)
Charge for the year	(2,851)	(9,948)	(19,288)	-	(32,087)
Eliminated on disposals	318	1,637	3,704	-	5,659
At 31 March 2014	(35,736)	(62,409)	(146,223)	-	(244,368)
Net book amount at 31 March 2014	186,149	757,406	180,382	82,571	1,206,508
Net book amount of leased assets included above	3,713	706	7,432	-	11,851
Assets under construction relate to the following categories	6,574	34,650	41,347	-	82,571
Cost					
At 1 April 2012	207,040	708,791	278,314	82,838	1,276,983
Reclassifications	(303)	(118)	421	-	-
Additions	-	-	-	92,442	92,442
Transfers	11,329	45,068	21,472	(77,869)	-
Disposals	(1,047)	(2,410)	(4,255)	-	(7,712)
At 31 March 2013	217,019	751,331	295,952	97,411	1,361,713
Accumulated depreciation					
At 1 April 2012	(30,596)	(46,287)	(117,096)	-	(193,979)
Charge for the year	(2,799)	(10,221)	(17,723)	-	(30,743)
Eliminated on disposals	192	2,410	4,180	-	6,782
At 31 March 2013	(33,203)	(54,098)	(130,639)	-	(217,940)
Net book amount at 31 March 2013	183,816	697,233	165,313	97,411	1,143,773
Net book amount of leased assets included above	3,840	706	7,871		12,417
Assets under construction relate to the following categories	4,915	51,811	40,685		97,411

The Group's index linked loans and listed bonds are secured on certain assets of the Group (see note 19).

Notes to the Group financial statements
for the year ended 31 March 2014

14. Investments in subsidiaries

Details of the Company's subsidiary, the results of which are included in the Group financial statements at 31 March 2014 and 31 March 2013 are as follows:

Name of subsidiary	Place of incorporation	Principal activity	Ownership interest %	Voting rights held %
South East Water (Finance) Limited	Cayman Islands	Finance Company	100	100

South East Water (Finance) Limited's principal purpose is to raise listed debt on behalf of South East Water Limited and any proceeds from such issues are lent on to South East Water Limited. South East Water (Finance) Limited is tax resident in the UK.

15. Investments

	2014 £000	2013 £000
Non-current assets		
Loans receivable carried at amortised cost		
Amount due from parent due in more than one year	**190,013**	190,013

The amount due from parent undertaking falls due for repayment on 27 July 2034 and bears interest at the rate of LIBOR plus 2%.

16. Inventories

	2014 £000	2013 £000
Consumables	**184**	78
Work-in-progress	**83**	58
	267	136

17. Trade and other receivables

	2014 £000	2013 £000
Financial asset receivables		
Trade receivables	**29,607**	28,483
Accrued income	**27,823**	24,364
Amounts due from parent and fellow subsidiary undertakings due within one year	**17**	21
	57,447	52,868
Non-financial asset receivables		
Prepayments and accrued income	**3,345**	3,366
Other receivables	**2,921**	2,534
	6,266	5,900
Total trade and other receivables	**63,713**	58,768

Notes to the Group financial statements
for the year ended 31 March 2014

17. Trade and other receivables *(continued)*

All trade receivables at 31 March 2014 and 31 March 2013 are denominated in sterling.

Trade receivables are stated after provision for doubtful debts of £29.6million (2013: £27.6 million). They are non-interest bearing and generally for immediate settlement. Receivables are determined to be impaired where there is a poor payment history or insolvency of the debtor and are fully or partially provided for.

Movements in the provision for impairment of receivables were as follows:

	2014 £000	2013 £000
Provision brought forward	**27,642**	26,545
Charge for the year	**3,750**	2,718
Amounts written off	**(1,791)**	(1,621)
Provision carried forward	**29,601**	27,642

As at 31 March, the analysis of trade receivables past due but not impaired is as follows:

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	120-365 days £000	>365 days £000
2014	29,607	4,313	4,353	2,386	1,569	1,435	9,560	5,991
2013	28,483	4,281	4,299	2,299	1,332	1,259	9,232	5,781

18. Cash and cash equivalents

Cash and cash equivalents comprise the following at 31 March:

	2014 £000	2013 £000
Cash at bank and in hand	**610**	15,670
Short-term bank deposits	**52,100**	83,824
	52,710	99,494

At 31 March 2014, £0.4 million (2013: £18.2 million) of restricted cash is held in designated bank accounts in order to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans (note 19).

19. Financial liabilities

	2014 £000	2013 £000
Non-current liabilities: summary analysis		
Loans and borrowings	853,338	840,442
Derivative financial instruments – Inflation swap	82,971	81,917
Trade and other payables	1,012	955
	937,321	923,314

Notes to the Group financial statements
for the year ended 31 March 2014

19. Financial liabilities *(continued)*

		2014 £000	2013 £000
Loans and borrowings: detailed analysis			
Irredeemable debenture stock	(i)	**1,048**	1,048
Listed bonds due after five years	(iii)	**513,784**	509,421
Index linked loans	(iv)	**338,506**	328,736
Obligations under finance leases	(v)	**-**	1,237
		853,338	840,442
Trade and other payables: detailed analysis			
Trade payables	(vi)	**832**	735
Financial guarantee fees received in advance	(vi)	**180**	220
		1,012	955
Current liabilities			
10 % debenture stock 2014/2017	(ii)	**-**	3,000
Obligations under finance leases	(v)	**1,237**	1,149
		1,237	4,149
(i) Irredeemable debenture stock			
3 % perpetual stock		**26**	26
3 ½ % perpetual stock		**391**	391
4 % perpetual stock		**178**	178
5 % perpetual stock		**415**	415
5 ½ % perpetual stock		**1**	1
6 % perpetual stock		**37**	37
		1,048	1,048

Interest on irredeemable debenture stock is payable six monthly.

	2014 £000	2013 £000
(ii) Redeemable debenture stock		
10 % debenture stock 2014/2017	**-**	3,000
	-	3,000

The Group redeemed the entire stock of 10% redeemable debentures on 30 June 2013 at par.

Notes to the Group financial statements
for the year ended 31 March 2014

19. Financial liabilities *(continued)*

(iii) Listed bonds due after five years
The Group holds £496 million (2013: £496 million) of bonds listed on the London Stock Exchange, with effective terms, having taken account of a related interest rate swap, as follows:
- £200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Group);
- £166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the Group); and
- £130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the Group).

Issue costs incurred by the Group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation on the bond repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also accrues on the bond repayable in 2041 under the terms of the bond.

Listed bonds are stated at the original consideration received plus accrued indexation less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Total £000
2014				
Original loan consideration	200,000	166,000	130,000	496,000
Indexation on bonds	-	-	22,000	22,000
Less: unamortised issue costs	(1,192)	(1,658)	(1,366)	(4,216)
Listed bonds due after five years	198,808	164,342	150,634	513,784
2013				
Original loan consideration	200,000	166,000	130,000	496,000
Indexation on bonds	-	-	18,014	18,014
Less: unamortised issue costs	(1,408)	(1,768)	(1,417)	(4,593)
Listed bonds due after five years	198,592	164,232	146,597	509,421

(iv) Index linked loans
The Group holds £269 million of index linked loans with effective terms as follows:
- £135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the Group);
- £34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the Group); and
- £100 million at a variable rate linked to inflation (taken out during the prior year), falling due for repayment on 1 December 2037 (or earlier at the option of the Group).

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the Group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Notes to the Group financial statements
for the year ended 31 March 2014

19. Financial liabilities *(continued)*

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Loan due 2037 £000	Total £000
2014				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	57,800	11,037	4,250	73,087
Less: unamortised issue costs	(1,524)	(274)	(1,783)	(3,581)
Loans due after five years	191,276	44,763	102,467	338,506
2013				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	51,932	9,667	1,889	63,488
Less: unamortised issue costs	(1,606)	(287)	(1,859)	(3,752)
Loans due after five years	185,326	43,380	100,030	328,736

The irredeemable debentures, listed bonds and index linked loans detailed in (i), (iii) and (iv) above respectively are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence. The agreements for the bonds and loans contain a number of covenants that the Group is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report on page 5.

(v) Finance leases

The Group has finance lease contracts for various items of plant and machinery. Future minimum lease payments under finance leases, together with the present value of the net minimum lease payments are as follows:

	Minimum payments 2014 £000	**Present value of payments 2014 £000**	Minimum payments 2013 £000	Present value of payments 2013 £000
Within one year	**1,332**	**1,237**	1,332	1,149
In second to fifth years	**-**	**-**	1,333	1,237
	1,332	**1,237**	2,665	2,386
Less: future finance charges	**(95)**		(279)	
Present value of minimum lease payments	**1,237**		2,386	
Non-current		**-**		1,237
Current		**1,237**		1,149
		1,237		2,386

Each finance lease is secured against the asset to which it relates, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence. Each lease can be cancelled before its termination date or renewed for a secondary period at the option of the Group.

Notes to the Group financial statements
for the year ended 31 March 2014

19. Financial liabilities *(continued)*

Payments which will be made as part of the secondary lease period for assets held under finance lease are negligible.

(vi) Trade and other payables
Trade and other payables comprise financing guarantee fees of £180,000 (2013: £220,000) and deposits payable to developers of £832,000 (2013: £735,000). Financing guarantee fees waived comprises cash received in advance to settle fees in connection with the £200 million listed debt raised (see (iii)) which were subsequently waived. The balance is being amortised over the life of the listed debt.

20. Provisions

	2014 **£000**	2013 £000
As at 1 April	1,728	1,535
Additional provisions	2,446	1,353
Amounts utilised	(941)	(1,160)
As at 31 March	3,233	1,728

Provisions comprise compensation payments in excess of the Group's insurance cover of £1.7 million (2013: £1.6 million) and payments of leak allowances of £1.4 million (2013: £nil). It is anticipated that all provisions will be utilised within a two year period.

21. Trade and other payables

	2014 **£000**	2013 £000
Financial liability payables		
Trade payables	**13,784**	13,587
Amounts due to parent and fellow subsidiary undertakings	**10,144**	10,728
Other payables	**1,398**	501
Accruals	**32,299**	40,108
	57,625	64,924
Non-financial liability payables		
Payments received in advance	**29,436**	27,426
Other taxes and social security	**889**	811
	30,325	28,237
	87,950	93,161

As at 31 March 2014 and 2013, amounts due to parent and fellow subsidiary undertakings represent unsecured non-interest bearing balances relating to the surrender of group tax relief.

Notes to the Group financial statements
for the year ended 31 March 2014

22. Financial instruments

Financial risk management objectives and policies

The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, a loan to its parent undertaking, cash, short-term and medium-term deposits and trade receivables and trade and other payables. The main purpose of the Group's financial instruments other than the interest rate swap is to raise finance for the Group's operations.

Derivative activity is undertaken as determined by the Board of Directors. The Board considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The Group does not use derivative financial instruments for speculative purposes.

The Group's treasury operations are managed within parameters defined by the Board and its parent undertaking. It is the Group's policy to minimise liquidity risk within an acceptable range of interest rates. The Group does not use foreign currency financial instruments. The main risks arising from the Group's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the Group.

Interest rate and cash flow risk
The Group finances its activities through a mixture of cash generated from operations, debenture loans, finance leases, long-term bonds and long-term index linked loans. Debentures are long-term fixed rate loans. Bonds comprise long-term fixed rate loans and long-term variable rate loans which have been linked to inflation, partly through the use of an interest rate swap. The interest rate swap is used in order to reflect movements in the expected future income of the Group. Long-term index linked loans comprise loans linked to inflation. Finance leases are fixed rate instruments. The Group's policy is to manage short-term interest rate risk by using short-term fixed rate drawdowns under a committed facility. During the year to 31 March 2014 there was a net outflow of £4.1 million from financing activities within the Group (excluding dividend payments) (2013: inflow of £94.0 million). It is the view of the Group that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the Group.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, on the Group's profit before tax (through the impact on floating rate borrowings). The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments.

	Increase/ decrease in basis points	Effect on profit before tax £000	Effect on Shareholders' equity £000
2014			
Sterling	+200	(4,800)	(3,696)
Sterling	-200	4,800	3,696
2013			
Sterling	+200	(4,800)	(3,648)
Sterling	-200	4,800	3,648

Liquidity risk
The Group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities. Short-term flexibility is achieved by varying the drawdown amounts under these facilities. Further details are given below and in note 19. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

Notes to the Group financial statements
for the year ended 31 March 2014

22. Financial instruments *(continued)*

Inflation risk
The Group manages its inflation risk on its financial liabilities through the use of an interest rate swap and other index linked bonds and loans (note 19). The Group considers that the inflation rate risk is effectively managed as OFWAT allows revenues to be increased in line with inflation.

Credit risk
The Group's financial assets include a loan due from its parent undertaking, short-term and medium-term bank deposits and trade receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets. The Group's credit risk is primarily attributable to its trade receivables, which are stated in the balance sheet at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions (see note 17). The Group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

Capital management risk
The objectives and management of the Group's capital management risk are discussed in the Strategic Report on page 14.

Fair values of financial assets and financial liabilities

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. In the opinion of the directors, the fair values of the financial assets and liabilities of the Group (apart from the specific items shown in the fair value table below) are not materially different from the book values.

The following tables provide a comparison by category of the carrying amount and the fair values of the Group's financial assets and financial liabilities at 31 March 2014.

	Notes	**Book Value 2014 £000**	**Fair Value 2014 £000**	Book Value 2013 £000	Fair Value 2013 £000
Loans and receivables					
Trade receivables	17	**57,447**	**57,447**	52,868	52,868
Cash	18	**52,710**	**52,710**	99,494	99,494
Amounts due from parent undertaking	15	**190,013**	**134,249**	190,013	190,013
		300,170	**244,406**	342,375	342,375
Financial liabilities at amortised cost					
Trade and other payables	21	**47,481**	**46,736**	54,196	54,196
Finance leases	19	**1,237**	**1,237**	2,386	2,386
Redeemable debentures	19	**-**	**-**	3,000	3,000
Irredeemable debentures	19	**1,048**	**719**	1,048	737
Listed bonds	19	**600,971**	**636,459**	514,014	545,433
Index linked loans	19	**342,087**	**354,910**	332,488	429,752
Amounts due to parent and group undertakings	21	**10,144**	**9,985**	10,728	10,728
		1,002,968	**1,050,048**	917,860	1,046,232
At fair value through profit and loss account					
Interest rate swap	23	**82,971**	**82,971**	81,917	81,917

Notes to the Group financial statements
for the year ended 31 March 2014

22. Financial instruments *(continued)*

The net book value is considered to equate to the fair value for trade receivables, trade and other payables, finance leases, redeemable debentures and amounts due to parent and group undertakings due to the short maturity of the amounts receivable and payable. The fair value of amounts due from parent, irredeemable debentures and index-linked loans have been calculated by discounted cash flow methods using appropriate discount rates in effect at the balance sheet dates. The fair values of listed bonds are based on market prices. The book value of the interest rate swap has been adjusted to reflect its fair value.

Maturity of financial instruments

The table below summarises the maturity profile of the Group's financial assets and liabilities based on contractual undiscounted payments:

Year ended 31 March 2014	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Finance leases	1,332	-	-	-	1,332
Irredeemable debentures	45	45	134	1,119	1,343
Listed bond	9,268	9,268	27,805	267,953	314,294
Total fixed rate financial liabilities	10,645	9,313	27,939	269,072	316,969
Floating rate					
Floating rate financial assets:					
Short-term financial assets	57,447	-	-	-	57,447
Long-term financial assets	4,778	4,778	14,334	266,462	290,352
Total floating rate financial assets	62,225	4,778	14,334	266,462	347,799
Floating rate financial liabilities:					
Short-term financial liabilities	57,625	-	-	-	57,625
Listed bond	12,211	12,548	39,903	706,347	771,009
Index-linked loans	10,943	11,178	34,935	706,512	763,568
Total floating rate financial liabilities	80,779	23,726	74,838	1,412,859	1,592,202

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

Notes to the Group financial statements
for the year ended 31 March 2014

22. Financial instruments *(continued)*

Year ended 31 March 2013	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Finance leases	1,332	1,333	-	-	2,665
Irredeemable debentures	45	45	135	1,170	1,395
Redeemable debentures	3,075	-	-	-	3,075
Listed bond	9,268	9,268	27,805	277,221	323,562
Total fixed rate financial liabilities	13,720	10,646	27,940	278,391	330,697
Floating rate					
Floating rate financial assets:					
Short-term financial assets	52,868	-	-	-	52,868
Long-term financial assets	5,159	5,159	15,477	274,274	300,069
Total floating rate financial assets	58,027	5,159	15,477	274,274	352,937
Floating rate financial liabilities:					
Short-term financial liabilities	64,924	-	-	-	64,924
Listed bond	11,904	12,291	39,242	744,961	808,398
Index linked loans	10,627	10,878	34,112	665,761	721,378
Total floating rate financial liabilities	87,455	23,169	73,354	1,410,722	1,594,700

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs with a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The Group held the following financial instruments measured at fair value:

31 March 2014	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Financial liabilities at fair value through profit and loss account				
Interest rate swap	(82,971)	-	(82,971)	-
31 March 2013				
Financial liabilities at fair value through profit and loss account				
Interest rate swap	(81,917)	-	(81,917)	-

Notes to the Group financial statements
for the year ended 31 March 2014

22. Financial instruments *(continued)*

The Group held the following financial instruments which are not measured at fair value but fair value disclosures are required:

31 March 2014	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Fair value of financial assets: loans and receivables				
Amounts due from parent undertaking	134,249	-	134,249	-
Fair value of financial liabilities at amortised cost				
Trade and other payables	(46,736)	-	(46,736)	-
Irredeemable debentures	(722)	-	(722)	-
Listed bonds	(636,459)	(636,459)	-	-
Index linked loans	(354,910)	-	(354,910)	-
Amounts due to parent and group undertakings	(9,985)	-	(9,985)	-
Total fair value of financial liabilities at amortised cost	(1,048,812)	(636,459)	(412,353)	-

During the reporting period ending 31 March 2014, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

Borrowing facilities

The Group has committed borrowing facilities of £141.0 million (2013: £137.0 million), of which £nil (2013: £nil) was drawn down. Any drawdowns under these facilities are repayable in less than one year.

Items of income, expense, gains and losses

The net gains or losses of the different classes of financial instruments on the income statement are:

	2014 £000	2013 £000
Financial assets, loans and receivables (see note 8)	**5,295**	5,789
Financial liabilities at amortised cost (see note 7)	**(47,472)**	(45,103)
Financial liabilities at fair value through profit or loss (see note 7)	**(1,053)**	(17,697)
Financial assets due to impairment (see note 17)	**(3,750)**	(2,718)

23. Derivative financial instruments

	2014 £000	2013 £000
Interest rate swap	**82,971**	81,917

As at 31 March 2014 the interest rate swap is stated at its fair value of a liability of £83.0 million (2013: £81.9 million). The increase of the fair value of the liability of £1.1 million (2013: £17.7 million) during the year has been recognised in the income statement in finance costs (see note 7).

Notes to the Group financial statements

for the year ended 31 March 2014

24. Retirement benefit schemes

With effect from 1 April 2013, the Group adopted IAS 19 (as revised in June 2011) Employee Benefits and has restated the comparative amounts below, where appropriate. The impact of this change in policy on the financial results of the Group is explained in note 2.

The South East Water pension scheme provides benefits to Group and former Group employees. Up until 17 June 2011, benefits were provided on either a defined benefit basis or a defined contribution basis depending on the category of membership. On 17 June 2011, all assets and liabilities of the defined contribution section of the scheme were transferred to a newly set-up separate pension scheme. From 17 June 2011 onwards, benefits from the South East Water pension scheme have been provided on a defined benefit basis only.

The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. From 6 April 1997, after taking independent actuarial advice, the Group decided to contract-out via the Protected Rights Test. With effect from 6 April 2012, the Government have removed the option for schemes to contract-out via a Protected Rights basis. From 6 April 2012, the Group has decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Group contribution rate was 33.8% (2013: 33.8%) of pensionable remuneration during the year plus an annual contribution of £5.95 million (2013: £5.95 million). The Group's future contribution rate is expected to be 33.8% of pensionable salary plus a maximum annual contribution of £5.95 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2013 for the year to 31 March 2014). The overall gross expected return on assets used for the start year figures was 4.46% p.a. (2013: 4.79%).

The assumptions for the expected rate of return for each class of asset are detailed in the table on page 72.

The pension expense for the year to 31 March 2014 takes account of assumptions set at the start of the year (i.e. as at 1 April 2013). The calculation of the pension expense for the year to 31 March 2014 uses an expected rate of return after deducting an allowance for expenses. The expenses paid over the year to 31 March 2014 are equivalent to a deduction of 0.6% (2013: 0.6%) from the expected return on assets. Therefore an overall net expected return on assets of 3.86% (2013: 4.19%) has been used in the calculation of the 2014 pension cost.

As a result of the merger of SEW Limited and MKW Limited in October 2006, the Group acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Group contributed 36.1% (2013: 36.1%) of pensionable remuneration plus £1.35 million (2013: £1.35 million) in respect of the deficit as at 31 March 2014 to the scheme during the year. The Group's future contribution rate is expected to be 36.1% of pensionable salary plus a maximum annual contribution of £1.35 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2013 for the year to 31 March 2014). The overall gross expected return on assets used for the start year figures was 4.43% p.a. (2013: 4.56%).

The assumptions for the expected rate of return for each class of asset are detailed in the table on page 72.

On 31 March 2015 both of the Group's defined benefit schemes will close to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members will become deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members will be invited to join the Group's defined contribution scheme from 1 April 2015.

Notes to the Group financial statements
for the year ended 31 March 2014

24. Retirement benefit schemes *(continued)*

Pension costs recognised in the profit and loss account for the defined contribution scheme were as follows:

	2014	2013
	£000	£000
Defined contribution scheme	**517**	237

The major assumptions used for the actuarial valuations were:

	SEW Pensions 2014	SEW Pensions 2013	**MKW Pensions 2014**	MKW Pensions 2013
	%	%	**%**	%
Main assumptions:				
Rate of increase in salaries	**-**	3.60	**-**	3.60
Rate of increase in pensions in payment	**2.35**	2.35	**3.35**	3.35
Rate of increase in deferred pensions	**2.35**	2.35	**2.35**	2.35
Discount rate	**4.20**	4.15	**4.20**	4.15
RPI assumption	**3.35**	3.35	**3.35**	3.35
CPI assumption	**2.35**	2.35	**2.35**	2.35
Post-retirement mortality (in years)				
Current pensioners at 65 – male	**23.4**	23.9	**23.4**	23.9
Current pensioners at 65 – female	**25.2**	25.7	**25.2**	25.7
Future pensioners at 65 – male	**26.2**	26.7	**26.2**	26.7
Future pensioners at 65 – female	**27.2**	27.9	**27.2**	27.9

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities	(Decrease)/ increase
	£000	%
0.1% increase to the discount rate	(4,200)	(1.6)
0.1% decrease to inflation	(4,200)	(1.6)
One year increase in life expectancy	7,900	3.0

Notes to the Group financial statements
for the year ended 31 March 2014

24. Retirement benefit schemes *(continued)*

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were:

	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Market Value £000	Total £000
2014					
Equities	6.65	22,181	6.65	15,571	37,752
Corporate bonds	3.60	46,120	3.60	33,038	79,158
Government bonds	2.85	49,414	2.85	37,713	87,127
Property	4.45	13,189	4.45	9,369	22,558
Cash	0.50	2,193	0.50	1,546	3,739
Total fair value of assets		133,097		97,237	230,334
Present value of funded obligations		(156,195)		(103,091)	(259,286)
Net under funding in funded plans		(23,098)		(5,854)	(28,952)
Present value of unfunded obligations		(4,278)		-	(4,278)
Deficit in the schemes		**(27,376)**		**(5,854)**	**(33,230)**
2013					
Equities	6.25	42,590	6.25	26,502	69,092
Corporate bonds	3.55	44,518	3.55	30,147	74,665
Government bonds	2.45	31,557	2.45	30,900	62,457
Property	4.05	11,117	4.05	8,229	19,346
Cash	0.50	395	0.50	596	991
Total fair value of assets		130,177		96,374	226,551
Present value of funded obligations		(159,159)		(104,566)	(263,725)
Net under funding in funded plans		(28,982)		(8,192)	(37,174)
Present value of unfunded obligations		(4,189)			(4,189)
Deficit in the schemes		(33,171)		(8,192)	(41,363)

Equity investments include Global Tactical Asset Allocation, Private Equity Fund and Absolute Return investments.

Notes to the Group financial statements
for the year ended 31 March 2014

24. Retirement benefit schemes *(continued)*

Analysis of amounts charged/ (credited) to income statement:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Current service cost	786	1,020	1,806
Administrative expenses	698	385	1,083
Amounts charged to operating profit	1,484	1,405	2,889
Net interest on defined liability	1,223	285	1,508
Total amount charged to income statement	**2,707**	**1,690**	**4,397**
2013 (restated)			
Current service cost	895	1,012	1,907
Past service cost	230	-	230
Administrative expenses	698	385	1,083
Exceptional item: Pension curtailment gains	(2,102)	(2,143)	(4,245)
Amounts charged to operating profit	(279)	(746)	(1,025)
Net interest on defined liability	1,106	727	1,833
Total amount charged/(credited) to income statement	827	(19)	808

Analysis of amounts recognised in the statement of comprehensive income:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Return on schemes' assets excluding interest income	(2,660)	(1,240)	(3,900)
Actuarial gain due to assumptions	3,679	2,597	6,276
Actuarial gain recognised in the statement of comprehensive income	**1,019**	**1,357**	**2,376**
Cumulative actuarial losses	**(26,985)**	**(29,055)**	**(56,040)**
2013 (restated)			
Return on schemes' assets excluding interest income	6,318	4,764	11,082
Actuarial loss due to assumptions	(17,433)	(1,185)	(18,618)
Actuarial (loss)/gain recognised in the statement of comprehensive income	(11,115)	3,579	(7,536)
Cumulative actuarial losses	(28,004)	(30,412)	(58,416)

Notes to the Group financial statements

for the year ended 31 March 2014

24. Retirement benefit schemes *(continued)*

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Opening defined benefit obligations	163,348	104,566	267,914
Current service costs	786	1,020	1,806
Interest cost	6,643	4,254	10,897
Contributions by scheme participants	299	291	590
Actuarial gains	(3,679)	(2,597)	(6,276)
Benefits paid	(6,924)	(4,443)	(11,367)
Closing defined benefit obligations	**160,473**	**103,091**	**263,564**
2013 (restated)			
Opening defined benefit obligations	146,068	103,611	249,679
Current service costs	895	1,012	1,907
Past service costs	230	-	230
Gains on curtailment	(2,102)	(2,143)	(4,245)
Interest cost	6,871	4,882	11,753
Contributions by scheme participants	305	300	605
Actuarial losses	17,433	1,185	18,618
Benefits paid	(6,352)	(4,281)	(10,633)
Closing defined benefit obligations	163,348	104,566	267,914

Reconciliation of fair value of plans' assets:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Opening fair values of schemes' assets	130,177	96,374	226,551
Expected return on assets	5,420	3,969	9,389
Contributions by scheme participants	299	291	590
Contributions by employer	7,483	2,671	10,154
Actuarial losses	(2,660)	(1,240)	(3,900)
Administrative expenses	(698)	(385)	(1,083)
Benefits paid	(6,924)	(4,443)	(11,367)
Closing fair values of schemes' assets	**133,097**	**97,237**	**230,334**
2013 (restated)			
Opening fair values of schemes' assets	116,985	89,149	206,134
Expected return on assets	5,765	4,154	9,919
Contributions by scheme participants	305	300	605
Contributions by employer	7,624	2,673	10,297
Actuarial gains	6,548	4,764	11,312
Administrative expenses	(698)	(385)	(1,083)
Benefits paid	(6,352)	(4,281)	(10,633)
Closing fair values of schemes' assets	130,177	96,374	226,551

Notes to the Group financial statements
for the year ended 31 March 2014

24. Retirement benefit schemes *(continued)*

The five year history of the schemes is as follows:

	2014 **£000**	2013 £000	2012 £000	2011 £000	2010 £000
SEW Pensions					
Fair value of scheme assets	**133,097**	130,177	116,985	108,209	100,135
Present value of defined benefit obligation	**(160,473)**	(163,348)	(146,068)	(128,676)	(148,931)
Deficit in the scheme	**(27,376)**	(33,171)	(29,083)	(20,467)	(48,796)
Experience adjustment on schemes' assets:					
Amount	**(3,378)**	5,948	387	659	20,888
Percentage of scheme's assets (%)	**(2.5)%**	4.6%	0.3%	0.6%	20.9%
Experience adjustments on schemes' liabilities:					
Amount	**-**	(200)	-	-	-
Percentage of the scheme's liabilities (%)	**-**	(0.1)%	-	-	-
MKW Pensions					
Fair value of plan assets	**97,237**	96,374	89,149	83,872	79,506
Present value of defined benefit obligation	**(103,091)**	(104,566)	(103,611)	(87,754)	(86,672)
(Deficit)/surplus in the scheme	**(5,854)**	(8,192)	(14,462)	(3,882)	(7,166)
Experience adjustment on schemes' assets:					
Amount	**(1,447)**	4,694	726	294	14,463
Percentage of schemes' assets (%)	**(1.5)%**	4.9%	0.8%	0.4%	18.2%
Experience adjustment on schemes' liabilities:					
Amount	**-**	(11,500)	-	-	-
Percentage of the schemes' liabilities (%)	**-**	(11.0)%	-	-	-

25. Deferred income

	2014 **£000**	2013 £000
As at 1 April	**58,442**	55,706
Received in the year	**10,315**	8,483
Released during the year	**(7,031)**	(5,747)
As at 31 March	**61,726**	58,442
Non-current	**58,282**	55,034
Current	**3,444**	3,408
	61,726	58,442

Amounts received towards above ground assets are released to the income statement over the period to which they are deemed to relate. Contributions received towards below ground assets are released to the income statement over the period that corresponds to the life of the asset to which the contribution relates, which is typically 100 years.

Notes to the Group financial statements
for the year ended 31 March 2014

26. Authorised and issued share capital

	2014	2013
	£000	£000
Allotted, issued, called up and fully paid		
49,312,354 ordinary shares of £1 each (2013: 49,312,354)	**49,312**	49,312

There is one class of ordinary share which carries no right of fixed income and no restrictions on dividends or capital repayment. The authorised share capital was £100 million at 31 March 2014 (2013: £100 million).

27. Cash flow from operating activities

	2014	2013 (restated)
	£000	£000
Profit for the year	**59,636**	39,020
Adjustments for:		
Income tax expense	**(8,209)**	2,550
Finance income	**(5,295)**	(5,789)
Finance costs	**50,033**	64,633
Depreciation	**32,087**	30,743
Amortisation of intangibles	**2,683**	2,189
(Profit)/loss on disposal of fixed assets	**(25)**	151
Release of deferred income	**(675)**	(639)
Difference between pension contributions paid and amounts recognised in the income statement	**(7,266)**	(11,551)
Changes in working capital:		
Increase in trade and other receivables	**(5,240)**	(4,865)
(Increase)/decrease in inventory	**(131)**	96
Increase in trade and other payables	**6,956**	4,028
Net cash generated from operations	**124,554**	120,566

28. Capital Commitments

	2014	2013
	£000	£000
Contracts placed for future capital expenditure not provided in the financial statements	**37,306**	45,915

29. Obligations under operating leases

	2014	2013
	£000	£000
Minimum lease payments under operating leases recognised as an expense in the year (see note 5)	**525**	530

Notes to the Group financial statements
for the year ended 31 March 2014

29. Obligations under operating leases *(continued)*

Future minimum lease payments under non-cancellable operating leases are as follows:

	Land and buildings 2014 £000	Land and buildings 2013 £000	**Vehicles and office equipment 2014 £000**	Vehicles and office equipment 2013 £000
Amounts for the following periods:				
- within one year	**355**	381	-	37
- in the second to fifth years	**533**	888	-	-
	888	1,269	-	37

30. Related party transactions

The Group's joint ultimate holding companies are Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia, which is resident in Australia, and Caisse de dépôt et placement du Québec, which is resident in Canada. It is the directors' belief that they control the Group jointly.

The group of companies into which results of the Group are consolidated is that headed by HDF (UK) Holdings Limited, a company registered in England and Wales. The consolidated financial statements of HDF (UK) Holdings Limited may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.

Transactions with the Group's parent company
An unsecured loan to the immediate parent company South East Water (Holdings) Limited of £190 million (2013: £190 million) is disclosed in note 15 under non-current receivables. Loan interest receivable during the year was £4.8 million (2013: £5.3 million). There was no interest outstanding as at 31 March 2014 (2013: £nil) included under trade and other receivables in note 17.

Also, as at 31 March 2014 the Group has a current account debt due to its parent company of £6.0 million (2013: £3.6 million) in respect of group tax relief payable.

Transactions with other related parties
As at 31 March 2014 the Group has net current account balances due to other related parties totalling £4.1 million (2013: £7.1 million), all relating to group tax relief payable.

Key management compensation is disclosed in note 6.

Contributions to retirement benefit schemes are disclosed in note 24.

Company profit and loss account

for the year ended 31 March 2014

	Notes	2014 £000	2013 (restated) £000
Turnover	32	**212,913**	207,248
Operating costs before exceptional item		**(137,908)**	(132,333)
Exceptional item: pension curtailment gain	34/54	**-**	4,245
Operating costs	34	**(137,908)**	(128,088)
Other operating income	33	**5,494**	5,089
Profit on ordinary activities before interest		**80,499**	84,249
Interest receivable and similar income	36	**5,261**	5,725
Interest payable and similar charges	37	**(48,575)**	(62,837)
Other finance expense	54	**(1,704)**	(2,784)
Profit on ordinary activities before taxation		**35,481**	24,353
Tax on profit on ordinary activities	38	**3,114**	(6,733)
Profit on ordinary activities after taxation		**38,595**	17,620

Profit for the year is generated entirely from continuing operations.

The accompanying notes are an integral part of this profit and loss account.

Company statement of total recognised gains and losses

for the year ended 31 March 2014

	Notes	2014 £000	2013 (restated) £000
Profit for the year		**38,595**	17,620
Actuarial gain/(loss) on pension scheme for the year	54	**1,451**	(7,706)
Deferred tax on defined benefit pension schemes	54	**(334)**	1,849
Impact of deferred tax rate change	54	**(1,708)**	(624)
Total recognised gains for the year		**38,004**	11,139
Prior year's capitalisation of interest		**4,037**	
Deferred tax on prior years' interest capitalised		**(538)**	
Total recognised gains since last annual report and financial statements		**41,503**	

The total recognised gains for the year ended 31 March 2013 includes a restatement for the change to the accounting policy for the capitalisation of interest. This has resulted in an increase in total recognised gains for that year of £4.0 million, of which £2.4 million is related to the years ending 31 March 2012 and prior. Deferred tax on the interest capitalised for prior years totals £0.5 million, of which £0.3 million relates to years prior to 1 April 2012.

Company balance sheet
as at 31 March 2014

	Notes	2014 £000	2013 (restated) £000
Non-current assets			
Tangible assets	40	**938,973**	893,799
Amount due from parent undertaking	42	**190,013**	190,013
		1,128,986	1,083,812
Current assets			
Stocks	41	**267**	136
Debtors	42	**63,168**	60,723
Investments		**52,100**	83,750
Cash at bank and in hand		**384**	570
		115,919	145,179
Creditors: amounts falling due within one year	43	**(89,652)**	(85,263)
Net current assets		**26,267**	59,916
Total assets less current liabilities		**1,155,253**	1,143,728
Creditors: amounts falling due after more than one year	44	**(937,321)**	(923,314)
Provisions for liabilities	45	**(3,233)**	(1,728)
Deferred tax liabilities	45	**(29,937)**	(37,276)
Deferred income	46	**(3,633)**	(3,019)
Net assets excluding pension liability		**181,129**	178,391
Defined benefit pension liability	54	**(26,584)**	(31,850)
Net assets including pension liability		**154,545**	146,541
Capital and reserves			
Called up share capital	47	**49,312**	49,312
Capital redemption reserve	48	**4,000**	4,000
Profit and loss account	49	**101,233**	93,229
Shareholder's funds	50	**154,545**	146,541

The accompanying notes are an integral part of this balance sheet.

The financial statements of South East Water Limited (registered number 02679874) on pages 78 to 106 were approved by the Board of Directors on 5 July 2014 and were signed on its behalf by:

P Butler
Managing Director
4 July 2014

J E Stimpson
Finance Director
4 July 2014

Company cash flow statement

for the year ended 31 March 2014

	Note	**2014 £000**	2013 £000
Net cash inflow from operating activities	51	**124,556**	120,572
Returns on investments and servicing of finance			
Interest paid		**(27,495)**	(31,893)
Interest received		**5,360**	4,931
Interest element of finance lease payments		**(211)**	(289)
Net cash outflow from returns on investments and servicing of finance		**(22,346)**	(27,251)
UK corporation tax paid/group relief		**(4,031)**	(5,165)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(100,060)**	(90,996)
Fixed asset contributions received		**3,989**	734
Net proceeds from disposal of tangible fixed assets		**205**	779
Net cash outflow from capital expenditure and financial investment		**(95,866)**	(89,483)
Equity dividends paid to shareholders		**(30,000)**	(31,000)
Net cash outflow before management of liquid resources and financing		**(27,687)**	(32,327)
Management of liquid resources		**31,650**	(69,850)
Financing			
Capital element of finance leases		**(1,149)**	(1,066)
Repayment of intercompany debtor		**-**	5,600
Proceeds on issue of intercompany loan		**-**	100,000
Redeemed debenture stock		**(3,000)**	(3,000)
Issue costs on intercompany loan		**-**	(1,896)
Net cash (outflow)/inflow from financing		**(4,149)**	99,638
Decrease in net cash		**(186)**	(2,539)
Reconciliation of decrease in net cash to movement in net debt:			
Net cash at the start of the year		**570**	3,109
Decrease in net cash (above)		**(186)**	(2,539)
Total cash		**384**	570
Opening borrowings		**(736,495)**	(605,330)
Net decrease/(increase) in borrowings from cash movements		**4,149**	(99,638)
Other non-cash changes		**(15,187)**	(31,527)
		(747,533)	(736,495)
Current asset investments		**52,100**	83,750
Net debt at the end of the year	52	**(695,049)**	(652,175)

At 31 March 2014, £0.1 million (2013: £3.2 million) of restricted cash is held in designated bank accounts in order to meet interest payments falling due in respect of the Company's senior debt (see note 44).

Notes to the Company financial statements

For the year ended 31 March 2014

31. Accounting policies

The principal accounting policies are summarised below. The policies were applied consistently throughout the current and prior years with the exception of the policy of the capitalisation of interest on borrowings, which was changed with effect from 1 April 2013 and is detailed below.

Basis of preparation

The Company has prepared financial statements in accordance with applicable UK accounting standards and under the historical cost convention and the Companies Act 2006, other than in respect of grants and contributions as described below and certain financial instruments that have been measured at fair value.

Judgements and key sources of estimation uncertainty

The preparation of financial statements requires the application of judgements, estimates and assumptions by management, which affects assets and liabilities at the balance sheet date and income and expenditure for the year.

The five points below are the most critical judgements, estimates and assumptions.

- un-invoiced water income at the year-end: domestic metered and smaller commercial customers are billed on a six monthly cycle which means at the year end a large volume of water has been supplied that has not been invoiced. Management estimates the value of the water supplied based on previous consumption. The value of unbilled water income at 31 March 2014 was £27.8 million (2013: £24.4 million);
- the capitalisation of employee and other directly attributable costs: The Company determines employee costs directly attributable to capital projects based on timesheet data. Other directly attributable costs are assessed by each relevant department where capital costs are incurred and costs relating to capital projects are then capitalised into the relevant project. During the year ended 31 March 2014 £10.7 million of employee and other directly attributable costs have been capitalised (2013: £10.0 million);
- the provision for doubtful trade receivables: an estimate for the provision for doubtful debts is calculated by the Company's management based on applying expected recovery rates to an aged debt profile. The value of the provision for doubtful debts as at 31 March 2014 was £29.6 million (2013: £27.6 million);
- the fair value of the interest rate swap: this valuation requires the Company to make estimates about expected inflation and future interest rates, hence the valuation is subject to uncertainties. The fair value at 31 March 2014 is £83.0 million (2013: £81.9 million); and
- pension and other post-employment benefits: the cost of defined benefit pensions schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets, and corporate bond performance projections as set out in note 54. Future salary increases and pension increases are based on expected future inflation rates. The net employee liability at 31 March 2014 is £26.6 million (2013: £31.8 million).

Turnover

Turnover arises solely in the United Kingdom and represents income from the supply of water and other chargeable services to customers. Turnover is recorded net of VAT and is stated before any deduction for bad and doubtful debts. The Company only recognises turnover in respect of "named" customers. Water charges are not levied on "the Occupier", or where the customer name is not known.

Metered and unmetered water income

Water income is recognised when water has been delivered to the customer. Water income includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data. Unmetered water income was invoiced in full for the financial year 2013/14 on 1 April 2013.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

Notes to the Company financial statements
For the year ended 31 March 2014

31. Accounting Policies *(continued)*

Research and development

Research and development expenses are charged to the profit and loss account in the year in which they are incurred.

Capitalisation of employee and overhead costs

Employee and overhead costs directly attributable to capital projects are capitalised in the financial statements as part of the cost of the assets to which they relate.

Taxation

Current tax, being UK Corporation tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in respect of the material tax effect of all timing differences between the treatment of certain items for taxation and accounting purposes, at the rates of tax expected to apply when the timing differences reverse. Deferred tax assets and liabilities recognised have been discounted at rates equivalent to the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with similar maturity dates. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Dividends

Dividends are recognised as a distribution when paid. Dividends are paid as declared. No unpaid dividend exists at the year end.

Infrastructure renewals accounting

Infrastructure assets comprise a network of systems relating to water distribution, such as water mains and surface reservoirs. Expenditure on infrastructure assets relating to enhancements and renewals of the network is treated as additions, and is included at cost. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost.

The depreciation charge for infrastructure assets is the estimated level of average annual expenditure required to renew the network based upon the Company's independently certified asset management plans. No other depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

Grants and contributions in respect of non-infrastructure assets

Grants and contributions received in respect of non-infrastructure assets are recognised as deferred income and released to the profit and loss account over the life of the assets to which they relate.

Grants and contributions in respect of infrastructure assets

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. Capital contributions towards infrastructure assets are deducted from the cost of these assets. This is not in accordance with the Companies Act 2006 and the regulations thereunder which require infrastructure assets to be stated at their purchase price or production cost and capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

The directors are of the opinion that, as infrastructure assets have no finite economic lives for the reason set out above and the capital contributions would therefore remain in the balance sheet in perpetuity, the treatment otherwise required by the Companies Act 2006 would not present a true and fair view of the Company's effective investment in infrastructure assets. Contributions received and the effect of this policy in the financial year is shown in note 40.

Notes to the Company financial statements

For the year ended 31 March 2014

31. Accounting Policies *(continued)*

Depreciation

Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. Infrastructure assets are depreciated using infrastructure renewals accounting as set out above. Other fixed assets are depreciated on a straight-line basis over their estimated useful lives as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and equipment	3-10

Borrowing costs

Borrowing costs are incurred on the Company's general borrowings. Where appropriate, borrowing costs are attributed to qualifying assets as permitted under FRS 15 Tangible Fixed Assets. Otherwise borrowing costs are expensed as incurred. See note 37 for further details of borrowing costs, including borrowing costs capitalised during the year and the impact on the comparative year's financial performance to which the change in policy of capitalising borrowing costs has been retrospectively applied.

Leases

Assets acquired under finance leases are included in tangible fixed assets and are depreciated on a straight-line basis over the shorter of the estimated useful life and the term of the lease. The related obligations, representing the capital element of future rentals, are included in creditors. The interest element of rentals is charged to the profit and loss account at a constant rate over the remaining life of the lease.

Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

Investments in subsidiaries

Investments are recorded at historical cost. Where the directors are of the opinion that there has been a permanent diminution in the value of investments, the carrying amount of such investments is written down to the recoverable amount.

The Company has one subsidiary, South East Water (Finance) Limited which is incorporated in the Cayman Islands but which is resident for tax purposes in the UK.

Stocks and work-in-progress

Stocks are valued at the lower of average cost or net realisable value. No value is placed upon stocks of treated water. Consumable chemical purchases are recognised as an expense in the profit and loss account at the point of purchase.

Work-in-progress for chargeable services is valued at the lower of cost and net realisable value.

Short-term trade and other receivables

Short- term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Company's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

Trade payables

Trade payables are measured at fair value and subsequently measured at amortised cost.

Notes to the Company financial statements

For the year ended 31 March 2014

31. Accounting Policies *(continued)*

Financial instruments

The Company's financial instruments comprise fixed and variable rate borrowings, fixed rate debentures, a derivative financial instrument comprising an interest rate swap, finance leases, a loan owed by its parent undertaking, cash, short-term and medium-term deposits, trade debtors and trade and other creditors.

The Company has taken the exemption allowed by FRS 29 to not make the financial instruments disclosure. These disclosures are included in the South East Water Group accounts.

Recognition
Financial instruments are recognised in the balance sheet when the Company becomes party to the contractual provisions of the instrument.

Derecognition
Financial liabilities are removed from the balance sheet when the related obligation is discharged, cancelled or expires.

Financial assets are removed from the balance sheet when the rights to the cash flows from the assets expire, or when the risks and rewards of ownership of the assets or when control of the assets is transferred.

Interest bearing loans and borrowings
All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Impairment
At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced in accordance with FRS 26 *Financial Instruments: Measurement*, with the loss being recognised in the profit and loss account in the year in which the respective assessment takes place.

Debt issue costs
Debt instruments are stated at the amount of net proceeds received. Issue costs incurred for the purpose of providing future funds are accounted for as a deduction from the amount of consideration received and amortised over the period of the loan to which the issue costs relate.

Embedded derivatives
Financial instruments that are not carried at fair value through profit and loss are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Derivative financial instruments
The Company uses derivative financial instruments in the form of interest rate swaps to hedge its risks associated with interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the balance sheet at fair value with any movements during the year charged or credited to the profit and loss account. The fair value is determined by reference to market values for similar instruments.

Provisions

A provision is recognised when the Company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Notes to the Company financial statements

For the year ended 31 March 2014

31. Accounting Policies *(continued)*

Pension benefits

The Company accounts for pension benefits under FRS 17 *Retirement Benefits.* The Company operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension schemes.

Defined contribution schemes
Contributions to defined contribution schemes are recognised as an operating expense when the contributions fall due.

Defined benefit schemes
The defined benefit pension scheme liability in the balance sheet represents the net present value of the defined benefit liability and the fair value of the scheme assets at the balance sheet date, and is disclosed after deferred taxation. It is shown on the face of the balance sheet above total net assets.

The present value of the defined benefit liability and the cost of providing benefits under defined benefit schemes is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

The pension cost charged to operating profit includes current and past service cost and the effect of any settlements and curtailments. Other finance cost or income comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities. Actuarial gains and losses and the related deferred taxation are recognised outside the profit and loss account in the statement of total recognised gains and losses.

32. Turnover

	2014	2013
	£000	£000
Unmetered water income	**81,636**	95,340
Metered water income	**127,827**	108,681
Other sales	**3,450**	3,227
	212,913	207,248

All turnover is from customers within the United Kingdom.

33. Other operating income

	2014	2013
	£000	£000
Rental income	**1,203**	1,222
Sundry income	**4,291**	3,867
	5,494	5,089

Sundry income includes charges to waste water companies for billing and cash collection services amounting to £2.3 million (2013: £2.1 million) and laboratory income of £1.0 million (2013: £0.9 million).

Notes to the Company financial statements
For the year ended 31 March 2014

34. Operating costs

	Notes	**2014 £000**	2013 £000
Wages and salaries	35	**22,786**	22,176
Exceptional item: pension curtailment gain		**-**	(4,245)
Fixed asset related expenses:			
Depreciation:			
- owned assets		**50,318**	48,157
- leased assets		**565**	1,426
Non-exceptional (profit)/loss on sale of fixed assets	40	**(25)**	151
Other operating charges			
Operating lease rentals:			
- vehicles and office equipment		**105**	127
- land and buildings		**420**	403
Fees payable to the Company's auditor		**174**	184
Other operating costs (see below)		**68,316**	64,377
Non-salary operating costs charged to capital projects		**(4,751)**	(4,668)
		137,908	128,088
Other operating costs include:			
Energy costs		**15,014**	12,751
Rates		**14,147**	13,728
Contractors		**10,757**	10,058
Bulk water supplies and abstraction licences		**9,189**	9,230
Bad debt charge		**3,771**	2,718
Chemicals		**2,633**	2,365
Insurance		**2,657**	2,729
Other		**10,148**	10,798
		68,316	64,377

35. Directors and employees

The average monthly number of persons, including salaried directors, employed by the Company during the year was:

	2014 Number	2013 Number
Operations	**490**	489
Management and administration	**299**	260
	789	749

Notes to the Company financial statements
For the year ended 31 March 2014

35. Directors and employees *(continued)*

The aggregate payroll costs of these persons were as follows:

	Notes	2014 £000	2013 £000
Wages and salaries		**23,998**	22,762
Social security costs		**2,430**	2,289
Defined benefit scheme pension costs	54	**1,768**	2,099
Defined contribution scheme pension costs	54	**517**	237
		28,713	27,387
Less: direct salary costs charged to capital projects and infrastructure renewals schemes		**(5,927)**	(5,211)
		22,786	22,176
Exceptional item: pension curtailment gain		**-**	(4,245)

Remuneration of the directors, who are the Group key management, is as follows:

	2014 £000	2013 £000
Aggregate emoluments including bonuses	**1,220**	1,262
Company contributions to defined contribution scheme	**25**	9
	1,245	1,271

Retirement benefits are accruing to five directors (2013: four) under the defined benefit pension schemes and one director (2013: one) under a defined contribution scheme.

Emoluments of the highest paid director are as follows:

	2014 £000	2013 £000
Aggregate emoluments including bonuses	**317**	277

Further disclosures in respect of Director's emoluments are set out in the Regulated Accounts of the company which are available on the Company website.

36. Interest receivable and similar income

	2014 £000	2013 £000
Interest receivable from group undertakings	**4,778**	5,347
On bank balances and short term deposits	**483**	378
	5,261	5,725

Notes to the Company financial statements

For the year ended 31 March 2014

37. Interest payable and similar charges

	2014	2013 (restated)
	£000	£000
Debenture interest	**119**	427
Interest on loans from group undertakings	**31,267**	46,133
Bank interest and other finance charges	**613**	462
Interest payable on index linked loan	**8,332**	8,074
Indexation on index linked loan	**7,239**	7,049
Financing guarantee fees	**1,538**	1,457
Interest payable on finance leases	**211**	289
Amortisation of issue costs	**548**	509
Other interest payable and similar charges	**505**	101
	50,372	64,501
Interest capitalised	**(1,797)**	(1,664)
	48,575	62,837

On 1 April 2014 the Company adopted a policy of capitalising appropriate borrowing costs on expenditure on qualifying assets. This has resulted in £1.8 million (2013 (restated): £1.7 million) being capitalised to fixed assets in the current year.

38. Taxation

	Note	**2014**	2013 (restated)
		£000	£000
Analysis of tax charge for the period			
Current tax			
UK Corporation tax charge on profits		**3,400**	3,914
Over provision in prior years		**-**	(252)
Total current tax charge		**3,400**	3,662
Deferred tax			
Origination and reversal of timing differences		**3,192**	(457)
Impact of deferred tax rate change		**(11,812)**	(3,751)
Decrease in discount		**1,281**	5,116
	45	**(7,339)**	908
Adjustments to deferred tax on pension movements		**1,537**	2,374
Impact of deferred tax rate charge on pension movements		**(712)**	(211)
Total deferred tax (credit)/charge		**(6,514)**	3,071
Tax (credit)/charge on profit on ordinary activities		**(3,114)**	6,733

Notes to the Company financial statements

For the year ended 31 March 2014

38. Taxation *(continued)*

	2014	2013 (restated)
	£000	£000
Factors affecting tax for the period		
Profit on ordinary activities before taxation	**35,481**	24,353
Profit on ordinary activities before taxation multiplied by the standard rate of tax of 23% (2013: 24%)	**8,161**	5,845
Effects of:		
Adjustment for non-taxable items	**215**	257
Capital allowances exceeding depreciation	**(1,443)**	(1,402)
Other timing differences	**(526)**	(192)
Adjustment to tax charge in respect of previous periods	**-**	(252)
Adjustment to tax for pensions FRS 17 charge	**(1,537)**	(2,374)
Timing difference on RPI indexation	**(1,470)**	1,780
Current tax charge for the year	**3,400**	3,662

Factors that may affect future tax charges

Capital investment is expected to remain at similar levels and the Company expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Limited group of companies.

Changes in the medium- and long-term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account.

39. Dividends

	2014 £000	2013 £000
Equity dividends paid during the year:		
First interim dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share	**7,500**	7,750
Second interim dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share	**7,500**	7,750
Third interim dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share	**7,500**	7,750
Final dividend of 15.21p per ordinary share (2013: 15.72p per ordinary share	**7,500**	7,750
	30,000	31,000

There were no dividends proposed for approval as at 31 March 2014 (2013: £nil). All dividends declared in the year were paid in the year up to March 2014.

Notes to the Company financial statements

For the year ended 31 March 2014

40. Fixed assets

Tangible fixed assets	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Assets in course of construction £000	Total £000
Cost					
At 1 April 2013	224,920	759,725	365,411	98,214	1,448,270
Additions	-	-	1,189	98,393	99,582
Disposals	(334)	(245)	(5,065)	-	(5,644)
Reclassification	(938)	1,092	(154)	-	-
Transfers	6,138	69,029	38,066	(113,233)	-
Grants and contributions	-	(3,345)	-	-	(3,345)
At 31 March 2014	229,786	826,256	399,447	83,374	1,538,863
Depreciation					
At 1 April 2013	(42,583)	(320,028)	(191,860)	-	(554,471)
Charge for the year	(2,818)	(26,123)	(21,942)	-	(50,883)
Disposals	318	245	4,901	-	5,464
At 31 March 2014	(45,083)	(345,906)	(208,901)	-	(599,890)
Net book amount at 31 March 2014	**184,703**	**480,350**	**190,546**	**83,374**	**938,973**
Net book amount of leased assets included above	3,713	706	7,432	-	11,851
Assets under construction relate to the following categories	6,574	34,650	41,347	-	82,571
Net book amount at 31 March 2013 (restated)	182,337	439,697	173,551	98,214	893,799
Net book amount of leased assets included above	3,840	706	7,871	-	12,417
Assets under construction relate to the following categories	4,915	51,811	40,685	-	97,411

The net book amount of land and buildings comprises:

	2014 £000	2013 £000
Freehold	**74,488**	75,568
Long leaseholds	**216**	220
Short leaseholds	**4**	4
	74,708	75,792

The net book amount of infrastructure assets at 31 March 2014 is stated after the deduction of grants and contributions amounting to £100.0 million (2013: £96.7 million) to give a true and fair view (see note 31).

Advanced capital contributions and deposits received in 2014 amounted to £3.5 million (2013: £3.3 million), and £3.3 million (2013: £3.4 million) was released to fixed assets.

Notes to the Company financial statements
For the year ended 31 March 2014

40. Fixed assets *(continued)*

Additions during the year include £1.8 million of borrowing costs. An adjustment has been made to the opening balances for borrowing costs in previous years which amount to £1.7 million in the year end 31 March 2013 and a further £2.4 million in the years prior to 1 April 2012 (see note 37). Cumulative interest capitalised at the 31 March 2014 totalled £5.8 million (2013 (restated): £4.0 million).

There is also a consequential deferred tax charge of £0.2 million in the year, with the deferred tax charges for the previous year of £0.2 million and for the years prior to 1 April 2012 of £0.3 million.

The interest rate applied to qualifying capital expenditure was 4.28% (2013 (restated): 4.05%).

Asset disposals were as follows:

	Proceeds 2014 £000	Proceeds 2013 £000	**Net Book Value 2014 £000**	Net Book Value 2013 £000	**Profit & Loss 2014 £000**	Profit & Loss 2013 £000
Land	**-**	49	1	49	(1)	-
Buildings	**-**	648	-	806	-	(158)
Reservoirs	**-**	-	15	-	(15)	-
Vehicles	**200**	86	91	58	109	28
Other	**5**	(4)	73	17	(68)	(21)
	205	779	180	930	25	(151)

Investments in subsidiaries
The carrying value of the Company's investment in its subsidiary is £100 (2013: £100) (see note 14).

41. Stocks

	2014 £000	2013 £000
Consumables	**184**	78
Work-in-progress	**83**	58
	267	136

Notes to the Company financial statements
For the year ended 31 March 2014

42. Debtors

	2014 £000	2013 £000
Financial asset debtors		
Trade debtors	**29,607**	28,483
Accrued income	**27,823**	24,364
Amounts due from parent and group undertakings	**17**	2,521
	57,447	55,368
Non-financial asset debtors		
Other debtors	**2,921**	2,534
Prepayments and accrued income	**2,800**	2,821
	5,721	5,355
Total due within one year	**63,168**	60,723
Amounts due from parent and group undertakings after more than one year	**190,013**	190,013
Total debtors	**253,181**	250,736

Trade debtors are stated after provision for doubtful debts of £29.6 million (2013: £27.6 million). They are non-interest bearing and for immediate settlement.

At 31 March, the age of trade receivables was as follows:

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	120-365 days £000	>365 days £000
2014	29,607	4,313	4,353	2,386	1,569	1,435	9,560	5,991
2013	28,483	4,281	4,299	2,299	1,332	1,259	9,232	5,781

Amounts due from parent and fellow subsidiary undertakings relate mainly to interest and group tax relief.

At 31 March 2014, the amounts due from the Company's parent undertaking after more than one year comprised £190.0 million (2013: £190.0 million) due from the parent company, falling due for repayment on 27 July 2034 and bearing interest at the rate of LIBOR plus 2%.

Notes to the Company financial statements

For the year ended 31 March 2014

43. Creditors: amounts falling due within one year

	2014 £000	2013 £000
Financial liability creditors		
Trade creditors	**13,784**	13,586
Redeemable debenture stock	**-**	3,000
Obligations under finance leases	**1,237**	1,149
Amounts due to parent and group undertakings	**16,912**	14,381
Accruals	**25,997**	24,411
	57,930	56,527
Non-financial liability creditors		
Payments received in advance	**29,436**	27,426
Other taxes and social security	**889**	811
Other creditors	**1,397**	499
	31,722	28,736
Creditors: amounts falling due within one year	**89,652**	85,263

At 31 March 2014 and 2013, amounts owed to parent and group undertakings represent unsecured non-interest bearing balances including the surrender of group tax relief to the Company.

The Company redeemed the entire stock of 10% redeemable debentures on 30 June 2013.

The Company has finance lease contracts for various items of plant and machinery with an effective interest rate for 2014 of 7.7% (2013: 7.7%). Each lease can be cancelled before its termination date or renewed for a secondary period at the option of the Company.

Finance leases are secured against the asset to which they relate, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence.

44. Creditors: amounts falling due after more than one year

		2014 £000	2013 £000
Irredeemable debenture stock	(i)	**1,048**	1,048
Obligations under finance leases	(ii)	**-**	1,237
Amounts due to group undertakings	(iii)	**699,222**	691,368
Index linked loans	(iv)	**236,039**	228,706
Trade creditors and other payables	(v)	**1,012**	955
Creditors : amounts falling due after more than one year		**937,321**	923,314

	2014	2013
(i) Irredeemable debenture stock		
3% perpetual stock	**26**	26
3½% perpetual stock	**392**	392
4% perpetual stock	**177**	177
5% perpetual stock	**415**	415
5½% perpetual stock	**1**	1
6% perpetual stock	**37**	37
	1,048	1,048

Notes to the Company financial statements
For the year ended 31 March 2014

44. Creditors: amounts falling due after more than one year *(continued)*

(ii) Finance leases
The maturity of obligations under finance leases is as follows:

	2014	2013
	£000	£000
Between one and two years	**-**	1,237

(iii) Amounts due to group undertakings
The Company's subsidiary undertaking, South East Water (Finance) Limited, has £596 million (2013: £596 million) of debt listed on the London Stock Exchange. The funds raised are lent to the Company under loan agreements between the Company and its subsidiary. An annual fee of £43,000 (2013: £43,000) is charged by South East Water (Finance) Limited.

The effective terms of the £596 million loans due to South East Water (Finance) Limited are as follows:
- £200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Company);
- £166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the Company);
- £130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the Company); and
- £100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the Company).

Issue costs incurred by the Company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation on the loan repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also accrues on the loan repayable in 2041 under the terms of the loan.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence.

The agreements for the bonds and loan contain a number of covenants that the Company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report on page 14.

The amounts due to group undertakings are stated at the original consideration plus fair value of the interest rate swap, accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019	Loan due 2029	Loan due 2041	Loan due 2037	Total
	£000	£000	£000	£000	£000
2014					
Original loan consideration	200,000	166,000	130,000	100,000	596,000
Fair value of interest rate swap	82,971	-	-	-	82,971
Indexation on bonds	-	-	22,000	4,250	26,250
Less: unamortised issue costs	(1,192)	(1,658)	(1,366)	(1,783)	(5,999)
Listed bonds due after five years	281,779	164,342	150,634	102,467	699,222

Notes to the Company financial statements
For the year ended 31 March 2014

44. Creditors: amounts falling due after more than one year *(continued)*

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Loan due 2037 £000	Total £000
2013					
Original loan consideration	200,000	166,000	130,000	100,000	596,000
Fair value of interest rate swap	81,917	-	-	-	81,917
Indexation on bonds	-	-	18,014	1,889	19,903
Less: unamortised issue costs	(1,408)	(1,768)	(1,417)	(1,859)	(6,452)
Listed bonds due after five years	280,509	164,232	146,597	100,030	691,368

(iv) Index linked loans

The Company holds £169 million of index linked loans with effective terms as follows:

- £135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the Company); and
- £34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the Company).

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the Company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence.

The agreements for both loans contain a number of covenants that the Company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report on page 14.

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Total £000
2014			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	57,800	11,037	68,837
Less: unamortised issue costs	(1,524)	(274)	(1,798)
Index-linked loans	191,276	44,763	236,039
2013			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	51,932	9,667	61,599
Less: unamortised issue costs	(1,606)	(287)	(1,893)
Index-linked loans	185,326	43,380	228,706

Notes to the Company financial statements

For the year ended 31 March 2014

44. Creditors: amounts falling due after more than one year *(continued)*

(v) Trade creditors and other payables

Trade creditors and other payables comprise financing guarantee fees of £180,000 (2013: £220,000) and deposits payable to developers of £832,000 (2013: £735,000). Financing guarantee fees are cash received in advance to settle fees in connection with the £200 million owed to South East Water (Finance) Limited (see (iv)) which were subsequently waived. The balance is being amortised over the life of the listed debt.

45. Provisions for liabilities

	Other provisions £000	Deferred tax £000	Total £000
At 1 April 2013	1,728	37,276	39,004
Additional provisions charged to profit and loss account	2,446	-	2,446
Amounts utilised	(941)	-	(941)
Amounts unused and reversed	-	(7,339)	(7,339)
At 31 March 2014	3,233	29,937	33,170

Other provisions largely relate to compensation payments in excess of the Company's insurance cover of £1.7 million (2013: £1.6 million) and payments of leak allowances of £1.4 million (2013: £nil). It is anticipated that these provisions will be utilised within a two year period.

Deferred tax provision

	2014 £000	2013 £000
Accelerated capital allowances	**81,011**	91,433
Discount	**(48,934)**	(50,216)
Discounted accelerated capital allowances	**32,077**	41,217
RPI indexation	**(2,113)**	(3,900)
Discount	**122**	123
Discounted RPI indexation	**(1,991)**	(3,777)
Other	**(149)**	(164)
Total undiscounted provision excluding deferred tax on pension liability	**78,749**	87,369
Total discount	**(48,812)**	(50,093)
	29,937	37,276

Notes to the Company financial statements

For the year ended 31 March 2014

46. Deferred income

Income received for work not yet started or services not provided at the balance sheet date is as follows:

	2014	2013
	£000	£000
At 1 April	**3,019**	3,051
Received in the year	**6,970**	5,076
Released during the year	**(6,356)**	(5,108)
At 31 March	**3,633**	3,019

47. Authorised and issued share capital

	2014	2013
	£000	£000
Allotted, issued, called up and fully paid		
49,312,354 ordinary shares of £1 each (2013: 49,312,354)	**49,312**	49,312

There is one class of ordinary share which carries no right of fixed income and no restrictions on dividends or capital repayment. The authorised share capital is £100 million (2013: £100 million).

48. Capital redemption reserve

	2014	2013
	£000	£000
At 31 March	**4,000**	4,000

The capital redemption reserve relates to 4,000,000 8.75% redeemable preference shares redeemed on 31 March 1996.

49. Profit and loss account

	£000
Balance at 1 April 2013 as previously stated	89,730
Effect of change in accounting policy for the capitalisation of interest (see note 40)	3,499
Balance at 1 April 2013 as restated	93,299
Profit for the year	38,595
Dividends	(30,000)
Actuarial gain on pension schemes for the year	1,451
Deferred tax on defined benefit pension schemes	(2,042)
Retained profit for the year	8,004
At 31 March 2014	**101,233**

Of the profit and loss reserve above £22.7 million (2013: £22.7 million), which resulted from the merger of MKW Limited and SEW Limited, is not available for distribution.

Notes to the Company financial statements

For the year ended 31 March 2014

50. Reconciliation of movements in equity shareholder funds

	2014	2013 (restated)
	£000	£000
Opening shareholder funds (2014 was originally £143.0 million before adding £3.5 million prior year adjustment. 2013 was originally £164.3 million before adding £2.1 million prior year adjustment)	**146,541**	166,402
Total recognised gains and losses		
Profit for the year	**38,595**	17,620
Actuarial gain/(loss) on pension schemes for the year	**1,451**	(7,706)
Deferred tax on defined benefit pension schemes	**(2,042)**	1,225
	38,004	11,139
Dividends	**(30,000)**	(31,000)
Net movement on shareholder funds	**8,004**	(19,861)
Closing shareholder funds	**154,545**	146,541

51. Reconciliation of operating profit to net cash inflow from operating activities

	2014	2013
	£000	£000
Profit on ordinary activities before interest	**80,499**	84,249
Depreciation and impairment of tangible fixed assets	**50,883**	49,583
(Profit)/loss on disposal of fixed assets	**(25)**	151
(Increase)/decrease in stocks	**(131)**	96
Increase in trade and other debtors	**(3,837)**	(4,865)
Increase in creditors	**5,553**	4,030
Pension costs less contributions	**(8,386)**	(12,672)
Net cash inflow from operating activities	**124,556**	120,572

Notes to the Company financial statements
For the year ended 31 March 2014

52. Analysis of movement in net debt

	At 1 April 2013 £000	Cash flow £000	Other non-cash changes £000	**At 31 March 2014 £000**
Cash at bank and in hand	570	(186)	-	**384**
Irredeemable debenture stock	(1,048)	-	-	**(1,048)**
Redeemable debenture stock	(3,000)	3,000	-	**-**
Obligations under finance leases	(2,386)	1,149	-	**(1,237)**
Indexed linked loans	(169,000)	-	-	**(169,000)**
RPI indexation on loans	(61,599)	-	(7,238)	**(68,837)**
Less: unamortised issue costs	1,893	-	(95)	**1,798**
Amounts due to group undertakings	(596,000)	-	-	**(596,000)**
Indexation on amounts due to subsidiary	(101,820)	-	(7,401)	**(109,221)**
Less: unamortised issue costs	6,452	-	(453)	**5,999**
Group loans	190,013	-	-	**190,013**
Net borrowings	(736,495)	4,149	(15,187)	**(747,533)**
Current asset investments	83,750	(31,650)	-	**52,100**
Net debt	(652,175)	(27,687)	(15,187)	**(695,049)**

53. Commitments and contingent liabilities

Capital commitments

	2014 £000	2013 £000
Contracts placed for future capital expenditure not provided in the financial statements	**37,306**	45,915

Operating lease commitments

The Company's commitments in respect of non-cancellable operating leases for land and buildings and other operating leases are as follows:

	Land and buildings 2014 £000	Land and buildings 2013 £000	**Vehicles and office equipment 2014 £000**	Vehicles and office equipment 2013 £000
Amounts due next year on operating leases expiring:				
- within one year	**-**	25	**-**	37
- in second to fifth years inclusive	**355**	355	**-**	-
	355	380	**-**	37

Notes to the Company financial statements
For the year ended 31 March 2014

54. Pensions

The South East Water pension scheme provides benefits to Company and former Company employees. Up until 17 June 2011, benefits were provided on either a defined benefit basis or a defined contribution basis depending on the category of membership. On 17 June 2011, all assets and liabilities of the defined contribution section of the scheme were transferred to a newly set-up separate pension scheme. From 17 June 2011 onwards, benefits from the South East Water pension scheme have been provided on a defined benefit basis only.

The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. From 6 April 1997, after taking independent actuarial advice, the Company decided to contract-out via the Protected Rights Test. With effect from 6 April 2012, the Government have removed the option for schemes to contract-out via a Protected Rights basis. From 6 April 2012, the Company has decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Company contribution rate was 33.8% (2013: 33.8%) of pensionable remuneration during the year plus an annual contribution of £5.95 million (2013: £5.95 million). The Company's future contribution rate is expected to be 33.8% of pensionable salary plus a maximum annual contribution of £5.95 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2013 for the year to 31 March 2014). The overall gross expected return on assets used for the start year figures was 4.46% p.a. (2013: 4.79%).

The assumptions for the expected rate of return for each class of asset are detailed in the table on page 102.

The pension expense for the year to 31 March 2014 takes account of assumptions set at the start of the year (i.e. as at 1 April 2013). The calculation of the pension expense for the year to 31 March 2014 uses an expected rate of return after deducting an allowance for expenses. The expenses paid over the year to 31 March 2014 are equivalent to a deduction of 0.6% (2013: 0.6%) from the expected return on assets. Therefore an overall net expected return on assets of 3.86% (2013: 4.19%) has been used in the calculation of the 2014 pension cost.

As a result of the merger of SEW Limited and MKW Limited in October 2006, the Company acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2011.

The Company contributed 36.1% (2013: 36.1%) of pensionable remuneration plus £1.35 million (2013: £1.35 million) in respect of the deficit as at 31 March 2014 to the scheme during the year. The Company's future contribution rate is expected to be 36.1% of pensionable salary plus a maximum annual contribution of £1.35 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2013 for the year to 31 March 2014). The overall gross expected return on assets used for the start year figures was 4.43% p.a. (2013: 4.56%).

The assumptions for the expected rate of return for each class of asset are detailed in the table on page 102.

On 31 March 2015 both of the Group's defined benefit schemes will close to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members will become deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members will be invited to join the Group's defined contribution scheme from 1 April 2015.

Notes to the Company financial statements

For the year ended 31 March 2014

54. Pensions *(continued)*

Pension costs recognised in the profit and loss account for the defined contribution scheme were as follows:

	2014	2013
	£000	£000
Defined contribution scheme	**517**	237

The major assumptions used for the actuarial valuations were:

	SEW Pensions 2014	SEW Pensions 2013	**MKW Pensions 2014**	MKW Pensions 2013
	%	%	**%**	%
Main assumptions:				
Rate of increase in salaries	**-**	3.60	**-**	3.60
Rate of increase in pensions in payment	**2.35**	2.35	**3.35**	3.35
Rate of increase in deferred pensions	**2.35**	2.35	**2.35**	2.35
Discount rate	**4.20**	4.15	**4.20**	4.15
RPI assumption	**3.35**	3.35	**3.35**	3.35
CPI assumption	**2.35**	2.35	**2.35**	2.35

Post-retirement mortality (in years)

	SEW Pensions 2014	SEW Pensions 2013	**MKW Pensions 2014**	MKW Pensions 2013
Current pensioners at 65 – male	**23.4**	23.9	**23.4**	23.9
Current pensioners at 65 – female	**25.2**	25.7	**25.2**	25.7
Future pensioners at 65 – male	**26.2**	26.7	**26.2**	26.7
Future pensioners at 65 – female	**27.2**	27.9	**27.2**	27.9

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities	(Decrease)/ increase
	£000	%
0.1% increase to the discount rate	(4,200)	(1.6)
0.1% decrease to inflation	(4,200)	(1.6)
One year increase in life expectancy	7,900	3.0

Notes to the Company financial statements

For the year ended 31 March 2014

54. Pensions *(continued)*

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were:

	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Market Value £000	Total £000
2014					
Equities	6.65	22,181	6.65	15,571	37,752
Corporate bonds	3.60	46,120	3.60	33,038	79,158
Government bonds	2.85	49,414	2.85	37,713	87,127
Property	4.45	13,189	4.45	9,369	22,558
Cash	0.50	2,193	0.50	1,546	3,739
Total fair value of assets		133,097		97,237	230,334
Present value of funded obligations		(156,195)		(103,091)	(259,286)
Net under funding in funded plans		(23,098)		(5,854)	(28,952)
Present value of unfunded obligations		(4,278)		-	(4,278)
Deficit in the schemes		(27,376)		(5,854)	(33,230)
Related deferred tax asset		5,475		1,171	6,646
Deficit appearing in the Company's balance sheet		**(21,901)**		**(4,683)**	**(26,584)**
	SEW Pensions		MKW Pensions		
	Expected long-term rates of return %	Market Value £000	Expected long-term rates of return %	Expected long-term rates of return %	Market Value £000
2013					
Equities	6.25	42,590	6.25	26,502	69,092
Bonds	3.55	44,518	3.55	30,147	74,665
Index linked gilts	2.45	31,557	2.45	30,900	62,457
Property	4.05	11,117	4.05	8,229	19,346
Cash	0.50	395	0.50	596	991
Total fair value of assets		130,177		96,374	226,551
Present value of funded obligations		(159,159)		(104,566)	(263,725)
Net under funding in funded plans		(28,982)		(8,192)	(37,174)
Present value of unfunded obligations		(4,189)		-	(4,189)
Deficit in the schemes		(33,171)		(8,192)	(41,363)
Related deferred tax asset		7,629		1,884	9,513
Deficit appearing in the Company's balance sheet		(25,542)		(6,308)	(31,850)

Other investments include Global Tactical Asset Allocation, Private Equity Fund and Absolute Return investments.

Notes to the Company financial statements
For the year ended 31 March 2014

54. Pensions *(continued)*

Analysis of amounts charged to operating profit:

	Notes	SEW Pensions £000	MKW Pensions £000	Total £000
2014				
Current service cost		**769**	**999**	**1,768**
Past service cost		**-**	**-**	**-**
		769	**999**	**1,768**
2013				
Current service cost		877	992	1,869
Past service cost		230	-	230
Exceptional item: pension curtailment gains		(2,102)	(2,143)	(4,245)
		(995)	(1,151)	(2,146)

Analysis of amounts charged to other finance expense:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Expected return on pension schemes' assets	5,440	3,791	9,231
Interest on pension schemes' liabilities	(6,660)	(4,275)	(10,935)
Net charge to other finance expense	**(1,220)**	**(484)**	**(1,704)**
2013			
Expected return on pension schemes' assets	5,437	3,570	9,007
Interest on pension schemes' liabilities	(6,889)	(4,902)	(11,791)
Net charge to other finance expense	(1,452)	(1,332)	(2,784)

Analysis of amounts recognised in the statement of total recognised gains and losses:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Assumption gains on obligations	3,679	2,597	6,276
Actuarial losses arising on the schemes' assets	(3,378)	(1,447)	(4,825)
Actuarial gain recognised in the statement of total recognised gains and losses	301	1,150	1,451
Cumulative actuarial losses	**(27,703)**	**(29,262)**	**(56,965)**
2013			
Actual return less expected return on pension schemes' liabilities	(17,433)	(1,185)	(18,618)
Experience gains arising on the schemes' assets	5,948	4,964	10,912
Actuarial loss recognised in the statement of total recognised gains and losses	(11,485)	3,779	(7,706)
Cumulative actuarial losses	(28,004)	(30,412)	(58,416)

Notes to the Company financial statements
For the year ended 31 March 2014

54. Pensions *(continued)*

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Opening defined benefit obligations	163,348	104,566	267,914
Current service costs	769	999	1,768
Interest cost	6,660	4,275	10,935
Contributions by scheme participants	299	291	590
Actuarial gains	(3,679)	(2,597)	(6,276)
Benefits paid	(6,924)	(4,443)	(11,367)
Closing defined benefit obligations	**160,473**	**103,091**	**263,564**
2013			
Opening defined benefit obligations	146,068	103,611	249,679
Transfer of obligations into scheme	877	992	1,869
Current service costs	230	-	230
Past service costs	6,889	4,902	11,791
Interest cost	305	300	605
Contributions by scheme participants	17,433	1,185	18,618
Actuarial losses	(2,102)	(2,143)	(4,245)
Benefits paid	(6,352)	(4,281)	(10,633)
Closing defined benefit obligations	163,348	104,566	267,914

Reconciliation of fair value of plans' assets:

	SEW Pensions £000	MKW Pensions £000	Total £000
2014			
Opening fair values of schemes' assets	130,177	96,374	226,551
Expected return on assets	5,440	3,791	9,231
Contributions by scheme participants	299	291	590
Contributions by employer	7,483	2,671	10,154
Actuarial losses	(3,378)	(1,447)	(4,825)
Benefits paid	(6,924)	(4,443)	(11,367)
Closing fair values of schemes' assets	**133,097**	**97,237**	**230,334**
2013			
Opening fair values of schemes' assets	116,985	89,149	206,134
Expected return on assets	5,437	3,839	9,276
Contributions by scheme participants	305	300	605
Contributions by employer	7,854	2,673	10,527
Actuarial gains	5,948	4,694	10,642
Benefits paid	(6,352)	(4,281)	(10,633)
Closing fair values of schemes' assets	130,177	96,374	226,551

Notes to the Company financial statements

For the year ended 31 March 2014

54. Pensions *(continued)*

The five year history of the schemes is as follows:

	2014	2013	2012	2011	2010
	£000	£000	£000	£000	£000
SEW Pensions					
Fair value of scheme assets	**133,097**	**130,177**	116,985	108,209	100,135
Present value of defined benefit obligation	**(160,473)**	**(163,348)**	(146,068)	(128,676)	(148,931)
Deficit in the scheme	**(27,376)**	**(33,171)**	(29,083)	(20,467)	(48,796)
Experience adjustment on schemes' assets:					
Amount	**(3,378)**	**5,948**	387	659	20,888
Percentage of scheme's assets (%)	**(2.5)%**	**4.6%**	0.3%	0.6%	20.9%
Experience adjustments on schemes' liabilities:					
Amount	**-**	**(200)**	-	-	-
Percentage of the scheme's liabilities (%)	**-**	**(0.1)%**	-	-	-
MKW Pensions					
Fair value of plan assets	**97,237**	**96,374**	89,149	83,872	79,506
Present value of defined benefit obligation	**(103,091)**	**(104,566)**	(103,611)	(87,754)	(86,672)
Deficit in the scheme	**(5,854)**	**(8,192)**	(14,462)	(3,882)	(7,166)
Experience adjustment on schemes' assets:					
Amount	**(1,447)**	**4,694**	726	294	14,463
Percentage of schemes' assets (%)	**(1.5)%**	**4.9%**	0.8%	0.4%	18.2%
Experience adjustment on schemes' liabilities:					
Amount	**-**	**(11,500)**	-	-	-
Percentage of the schemes' liabilities (%)	**-**	**(11.0)%**	-	-	-

Deferred tax asset on pension liability:

	SEW Pensions £000	MKW Pensions £000	Total £000
At 1 April 2013	7,629	1,884	9,513
Charge to statement of total recognised gains and losses	(69)	(265)	(334)
Impact of tax rate change to total recognised gains and losses	(831)	(877)	(1,708)
Charge to profit and loss account	(1,264)	(273)	(1,537)
Impact of tax rate change to profit and loss account	10	702	712
At 31 March 2014	**5,475**	**1,171**	**6,646**

55 Subsequent events

There have been no post balance sheet events that require disclosure.

Notes to the Company financial statements

For the year ended 31 March 2014

56. Related party transactions

As a wholly-owned subsidiary of HDF (UK) Holdings Limited, the Company has taken advantage of the exemption under FRS 8 *Related Party Disclosures* not to provide information on related party transactions with other companies within the HDF (UK) Holdings Limited group.

57. Parent company and ultimate controlling parties

The Company's joint ultimate holding companies are Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia, which is resident in Australia and Caisse de dépôt et placement du Québec, which is resident in Canada. It is the directors' belief that they now control the Company jointly.

The immediate parent company is South East Water (Holdings) Limited.

The largest group of companies into which results of the Company are consolidated is that headed by HDF (UK) Holdings Limited, a company registered in England and Wales. The consolidated financial statements of South East Water Limited and HDF (UK) Holdings Limited may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.